August Commentary

Turning Points

If July was a month that was rewarding for our approach to investing in companies that offer quality and value for the long-term, August was a month that showed its challenges. At the beginning of the year we commented that this year would be decisive as the US economy overcomes the malaise of the past eight years, and economic growth, lower unemployment, and higher incomes allow the Fed to normalize its policy and begin raising rates. We said that the famous "New Normal" was likely to be more like the "Good Old Days". We also thought that there would be market volatility as we approached that turning point. Well, here we are!

Global markets were thrown into a turmoil that has not abated. Most markets for assets declined during the month. Stocks and bonds both declined. In US markets the S&P 500 declined -6%, better than European markets -7/-8%, emerging markets -7/-8% and Chinese markets -12%. Many of these moves were the largest seen in years. Oil and gold where among the only assets were up more than 1%.

Markets attributed the proximate cause for the declines to concerns about the prospects for the Chinese economy, for so long the driver of global growth, and the Chinese government's unexpected decision to allow its currency to depreciate against the US Dollar and other currencies. We discuss China and our views on what happened in our monthly insight entitled *Don't Junk China*. We argue that the Chinese economy is in a transition and is slowing as it shifts from investment to consumption led growth. However, we do not share the view that this slowdown is structural and somehow questions the sustainability of the Chinese economy. Instead we believe there are a number of good reasons why the Chinese governments changed course that will be supportive over time. China has achieved tremendous growth and prosperity for its people and we believe it has a long way to go.

We think that the turning point in the US economy is the real reason for the fright. A strong US will lead to higher rates, a higher US Dollar, and everything being equal pressure on other currencies and assets as money flows back into the US. It is just that everything else is not equal because US economic growth will benefit the rest of the world. Consumption and investment have a significant catch up to do and will lead to demand for products and services from all over the world. However, it is not just the US that has a positive outlook. Europe is not doing as badly as before and is growing from a lower base. Having spent trillions integrating East Germany, Germany is doing it again and embarking on a ten year multi-billion Euro stimulus program in the form of admitting 1% or more of its population as refugees to offset the demographic decline projected over the next 50 years. China should look better into next year as well.

We have to remember that rates are rising in the US because the US is doing well, and that this is a tremendously positive turning point. It will be entirely data driven as Janet Yellen has not ceased to hammer home, and whether it will take place this month, later this year, or next year, it will represent the beginning of the conclusion of perhaps the most successful episodes of central bank policy in financial history, the management of the great

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financial crisis of 2007/08.

For our stocks it has been a challenging month of course, although our global portfolios as a whole have outperformed their wider markets. M&A activity helped some of our stocks like *Cameron*, the US oil Services Company bought at a 50% premium by its much larger joint venture partner *Schlumberger* but hurt others like *Syngenta*, the Swiss crop protection and seed company, which declined after turning down a still low bid from *Monsanto*. Schlumberger itself actually stabilised and started recovering during the month as a result more of its low valuation than any near term hopes for a recovery in its business.

Among the worst performers in our portfolios where the high quality consumer products companies like *Anheuser-Bush In Bev* or *SAB Miller, Abbot* or *Mead Johnson*. Some of that has to be with the China jitters but a lot of it has to be the flows of institutional asset managers selling sectors that have done well and moving into cash or "rotating" into ones that have done less well. From a short term perspective it means that our portfolios have done rather less well than we would expect from the types of companies we own. From a long-term perspective however it means that the stock prices and valuations are lower so that they should do well going forward and in fact represent an opportunity to buy them at those lower prices from cash balances in accounts or new money.

For most of the companies we classify as global leaders with strong competitive positions and stable and recurring revenues share prices and valuations are compelling. For several of the companies we classify has global leaders with cyclical business like *United Technologies* or Schlumberger these share prices represent a opportunity to buy some of the highest quality companies in their fields at low if not distressed prices.

Turning points like the ones we are experiencing are not easy and there are likely to be rocky seas ahead as the Fed makes its move and markets respond. Our fundamental analysis of the businesses and the prospects of our companies supports the constructive view we have, and as long-term stewards of our client's assets we will continue to look to the horizon while charting our course.

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