

Commentary

TURBULENT TIMES

"I ask everybody to not think in two-to-three-year time frames, but to think in five-to-seven-year time frames. When somebody ... congratulates Amazon on a good quarter ... I say thank you. But what I'm thinking to myself is ... those quarterly results were actually pretty much fully baked about 3 years ago. Today I'm working on a quarter that is going to happen in 2020. Not next quarter. Next quarter for all practical purposes is done already and it has probably been done for a couple of years."

Jeff Bezos, 2017

In the middle of October's turbulent financial markets, on a day when *Amazon* reported revenue growth of 29% with its cloud computing business AWS growing 46% and its advertising business more than doubling, which we have been advocating as another driver for Amazon's growth and especially its profitability, yet it is trading off 8% or more on the day because markets were expecting the company's guidance to be slightly higher than it was, Jeff Bezos's comment about Amazon's long-term thinking is a particularly helpful reminder of what matters. Whether he is working on a quarter three, five or ten years from now, this is how companies grow and prosper over time.

This focus on the long-term is one of the key aspects of the quality we look for in investments. It is also why our outlook has not changed at all. As has been said about macro-economics, long-term investing is what we do, markets is what we put up with. We have no ability of forecasting short-term moves but we have been saying for months that we expect markets to become more volatile as we are in the middle of a turning point for the US and European economies and as we face significant political upheaval with the US midterms, the UK Brexit negotiations and the uncertain geopolitical situation.

The most important factor is the change in interest rate policy in the US. We are at a time in markets when people realize that for the first time since the financial crisis central banks, and in particular the US Federal Reserve, believe that the recovery is sustained and they can raise rates. This kind of moment will always be volatile as people worry about the sustainability of growth and the possibility of policy overshoot. But on a day when US GDP is reported to have grown at 3.5% in the last quarter, with inflation a moderate 1.6%, we must remember that the Fed is raising rates because the economy is doing well and I think whether under Bernanke, Yellen or now Powell it will be extremely careful not to choke off the economy.

With the third quarter earnings reporting under way it is striking how resilient the results have been. Our investments are biased to the strongest, most successful and competitive and most if not all of our companies have reported good numbers and solid outlooks. We place a great deal of importance on this first hand perspective of the companies we are invested in rather than headlines or indicators.

That is also why we look to market volatility like the present as an opportunity to make changes in our portfolios to take advantage of price dislocations to buy good companies for cheaper, whether that is in our equity or bond portfolios.

One of the potential long-term drivers of value generation could be blockchain. We talked last month about the discussion we hosted about blockchain in the supply chain with Bettina Warburg and Tom Serres of Animal Ventures, two thought leaders in the space. This month

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The Value of Long-Term Investing

Katerina Kosmopoulou has put together a summary of the discussion in our insight on *Blockchain: Enabling the next step change in supply chain management* as well as a link to their website and an article we think is well worth reading. You can follow the link [here](#) or click on the attachment. If you want to think about what is going to happen this quarter in three, five or ten years, blockchain and how it will enable a step change in corporate efficiency, sustainability and profitability would not be a bad place to start.

World Stars portfolio

Our World Stars Equity strategy closed September up 0.9% in US dollar terms, bringing performance to 12.2% year-to-date, versus the MSCI World at 5.8%.

Performance was led by gaming developer *Activision Blizzard*, which benefited from positive expectations on the upcoming launch of the latest iteration in its flagship Call of Duty franchise, Black Ops 4. With positive feedback from critics on the private beta of its battle royale game mode Blackout, the game looks set to become a meaningful revenue driver for the company.

Medical devices and nutrition provider *Abbot Laboratories* benefited from positive clinical data for its heart device MitraClip paving the way for the device to become the standard of care for patients suffering from mitral regurgitation, a potential fatal heart disease. Performance was also supported by broad based strength among our holdings in the industrials sector, including *United Technologies* and *Eaton*, which were both given attractive valuations amid the expectation of robust trends in key end markets.

On the negative side, global brewer *Anheuser Busch* continued to come under pressure on the back of continued macroeconomic concerns surrounding emerging markets. At the same time, revenue growth has continued to be muted as consumers globally seem to be choosing spirits over beer. Our investment thesis has been based on the realisation of cost synergies following the *SABMiller* acquisition, and revenue synergies as Anheuser could leverage its global distribution to roll out some of SABMiller's regional brands. Though some synergies have indeed materialised, the ongoing shift in consumer consumption preferences has limited the upside. As a result of this, we decided to exit the position and pursue more attractive reward opportunities.

Income-driven portfolios

Following last month's rout in emerging markets debt, September saw positive returns across the board with an overall return of 1.6% in US dollar terms, leaving the portfolio up 4.3% year-to-date.

While equities were up 1% (taking them up to 12.7% since the start of the year), the credit portfolio recovered strongly from the recent weakness with a positive 3.4% contribution for the month (making it almost flat for the year). The non-correlated funds are now up 4.5% year-to-date.

The recent repositioning of the credit portfolio to increase the expected return and improve the overall credit profile bore fruit, amid a move by the US Federal Reserve to continue raising interest rates, putting pressure on the most interest rate sensitive bonds. Despite this, the majority of our bonds in the portfolio showed positive returns. Some of the best

performers – which included *Tupras*, *YPF*, *QNB Finansbank* and *Turcell* - were some of the securities most affected by the recent market volatility.

Trade tensions between the US and China still remain the main concern for investors, especially regarding emerging markets securities. As a result, the whole market was punished without discrimination across all emerging market securities.

However, we take a disciplined investment approach and only invest for the long-term. Where most investors were worried about the trade tensions, our approach allowed us to benefit as our in-depth research of single issuers confirmed that the fundamentals of our emerging markets corporate bonds remained healthy.

Our portfolio is now well-positioned to generate solid cash flow and performance on a medium-term basis. So far this year our holdings have generated a 2.5% cash yield, and we are comfortable with how the portfolio is positioned for the rest of the year and into 2019.

Emerging market bond portfolios

Our Emerging Market portfolio had a strong rally in August, posting the best performance year-to-date with a return of 2.4%. The portfolio was boosted by a solid rally in Turkey and Argentina, as well as significant inflows to the asset class following the sharp correction in August. Year-to-date the portfolio is down -5.3% in total return (-3.96% if we exclude the *Rusal* position), but has generated 4.4% of income.

In recent months we have been actively repositioning the portfolio to shift our focus to quality low-leverage corporates in Argentina and Turkey that are both generating the bulk of their cash flows in USD and in a position to withstand the domestic economic turmoil, due to their dominant market position.

Going forward we believe that the volatility we have seen in the Emerging Market bonds sector will persist until the year end as concerns over Fed tightening policy and rising oil prices will continue to impact growth and inflation, whilst risks of trade barriers remain. We are continuing to weigh in all of the above factors when choosing which companies are the most attractive investments.

Despite the cautious comments from the investment community surrounding Emerging Markets, we are sanguine about the prospects for healthy future returns. Our BB-rated portfolio is currently showing a yield-to maturity of 8.3%, and a running yield of 7.25% for a duration of 3.6.

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