3 January 2020

Dear Equity Client

GLOBAL EQUITIES – 2020 Annual Letter

2019 PERFORMANCE

Investment returns for 2019 exceeded most expectations. The MSCI World Index (including Emerging Markets and dividends) delivered a +26.6% return over the year (in US$ terms; +21.7% in UK£ terms). Our Global Best Ideas Equity Fund (the "Fund") returned +30.7%[1] (US$ terms).

This strong result followed the weak stock market performance in 2018 and despite economic activity in the US and internationally moderating further in 2019. Global trade and the manufacturing sector in particular experienced weak activity, caused to some extent by uncertainties around the threatening US-Sino trade war. The inversion of the US yield curve caused material anxiety about growing risks for an imminent US recession.

These threats were countered by continuing strong consumer confidence in both the US and China, with personal consumption in the two largest economies continuing as the main pillar of these economies and supporting capital markets. Markets found further support from continuing low global inflation levels and the benefits of monetary easing in many economies, especially in the US. This kept interest rate levels at bay and postponed the next US recession. We also highlight the absence of material fundamental economic imbalances in the US economy.

The year may be remembered for the huge 'wall of worry' which mainly focused on geopolitical risks and a threatening recession that investors had to climb - and some were not willing to climb. Those who persisted were well rewarded.

2020 FUNDAMENTAL OUTLOOK

The Federal Reserve's prudency last year by changing tactic and starting to lower their target interest rate at the right time has created a more stable US economic environment. They joined similar monetary easing efforts in the other main regions, resulting in a synchronised and supportive global economic backdrop.

The strength of the consumer worldwide is a main feature for capital markets. Importantly, their balance sheets are generally sound, especially in both the US and in China, the two largest consumer markets. Monetary easing is expected to start filtering through to the manufacturing sector. Leading economic indicators have stabilised, with China's data in process of bottoming out. US recessionary fears have largely abated.

The US presidential election may trigger more stimulatory economic efforts. The US-Sino trade negotiations seem to be making constructive progress. We continue with our view of a 'stretched out' soft landing for the US economy. The international economic outlook also seems stable with more signs of improvement than material deterioration, especially in China. Questions are being raised as to when business results may start to improve, rather than overly fearing the current relatively soft earnings patch in some sectors.

Past performance should not be used as a guide to future performance.

[1] *B share class*

In summary, the overall global fundamental theme for 2020 is seen as averting a US recession with continuing moderate economic and organic business growth.

PERFORMANCE FOLLOWING AN EXCEPTIONAL YEAR

Investors may wonder whether a strong year like 2019 can be followed by reasonable results the following year. Strikingly, 2019 ended up only +2.7% since its 2018 peak level. Excluding last year's appreciation of +24.1%, there have been only seven instances where the MSCI World AC price index gained more than +20% since the index's inception in 1988. The average result in the ensuing year was positive, with two negative years.

The S&P 500 index has a longer history. Considering its data over the past 50 years, there have been 13 occasions of +25% results. Nine of the ensuing years delivered positive results. The average year two result was +11.2% (with the median result of +11.4%). This compares well with the 50-year average of +10.6%. Notably, both negative occasions (1981 and 1990) led into the respective US recessions.

While 2019 may be perceived as an exceptionally high base to improve upon, it obviously succeeded a low 2018 base. The year ended only +10.2% above the S&P 500 peak level in 2018. The compounded growth rate over the two years is +11.9% p.a., close to the 50-year average mentioned above. It therefore appears that 'normality still prevails' despite the strong 2019 result.

RISKS

Separate to recessionary fears, the capital markets are predominantly concerned about currency, inflation, interest rate and geopolitical risks.

The risk of an ever strengthening US Dollar seems to be abating following the Federal Reserve's about turn on their target rate, the UK election outcome and the stabilising China economy. It is possible that the Dollar can turn into a tailwind for the US economy and capital markets this year.

Fears for potentially rising US inflation levels have been relatively absent for some time. Low unemployment levels have not yet filtered through to particularly high wage growth. The oil price remains well contained while general technological advances are very cost effective. Inflation expectations currently remain below the Federal Reserve's 2% target level.

Real US interest rates are close to thirty year low levels. We expect absolute rates to also remain relatively low until economic activity improves. It may upset capital markets to some extent when rates move higher, but fundamentally the higher rates would happen for constructive economic reasons. More central banks may also consider moving away from negative rates, but yield spreads against earnings yields generally already provide for higher interest rates.

Geopolitical risks cannot be judged in advance, but fortunately they have less effect on the oil price (and cost structures) than before. We can expect some volatility in the run-up to the US election, but the point remains that investors value economic fundamental factors more than political rhetoric.

STOCK MARKET VOLATILITY

Investors have been spoilt with relatively low stock market volatility last year. This can be ascribed more to a dull economic environment and little excitement than to investor complacency (seeing the absence of any exuberance). Current volatility levels remain relatively low and may spike at times of heightened uncertainty (especially with potential geopolitical events), but we do not observe anything of particular fundamental economic concern in this context.

VALUATION LEVELS

The overall S&P 500 valuation levels are currently above average following the rising share prices and stagnating index earnings. We would need positive earnings revisions (which may well happen) to make a valuation case for equities.

The index is however fairly valued relative to interest rates considering levels since 2000, and attractively valued considering levels over the longer term. It is also fairly valued considering the historic relationship with inflation levels.

Some investors may have reservations about current equity valuations. An improving economic outlook is required to warrant valuation levels. Those odds seem to be growing currently.

INVESTMENT THEMES

We relentlessly adhere to our investment philosophy of owning high quality sustainable growth businesses to hold for the long term, and remain very valuation conscious. The Fund's holdings are not adjusted for evolving investor preferences in terms of geographic regions or investment styles.

The Fund is well exposed to the following main themes:

- **Direct to consumer** activities in some consumer businesses offer huge margin uplift and structural growth opportunities. We own Nike, Amazon and Walt Disney in this context.

- **Technology** remains a major focus area. The sector made a strong contribution last year, and we believe continues to offer structural growth opportunities in payment systems, cyber security, artificial intelligence and cloud services. We hold Microsoft, Amazon, PayPal, Visa, Alphabet, Accenture, Adobe and Tencent in the Fund.

- **Health Care** also remains a major focus area. We continue to prefer manufacturers to distributors, and also value the increasing utilisation of technology and the particular growth potential in surgical robotics. We hold Zoetis, Intuitive Surgical, Stryker and Becton Dickinson in our portfolio. Alphabet (Google) is starting to feature by successfully utilising AI in healthcare.

- The overall **consumer market** remains strong. The **emerging consumer** offers excellent structural growth potential. We prefer taking this exposure through high quality global franchises. Our fund has holdings in Estée Lauder, Nestlé and McDonald's in this context.

IN SUMMARY

Recessionary risks seem to be abating with growing expectations of an extended US economic cycle. An expected improving earnings cycle may compensate for higher equity valuations. We find good reason to remain well engaged and plan to continue investing Fund inflows.

We are grateful for all your support.

With kind regards

Gerrit Smit
Partner – Head of Equity Management

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