8 January 2021

Dear Equity Client

GLOBAL EQUITIES – 2021 Annual Letter

2020 PERFORMANCE

Investment returns for 2020 exceeded most expectations, especially considering the dire global economic backdrop. The MSCI World Index (including Emerging Markets and dividends) delivered a +16.3% return over the year (in US$ terms; +13.0% in UK£ terms).

The global virus crisis (GVC) dominated health, economic and investment considerations from early in the year. It very quickly triggered one of the deepest global recessions, with severe despair on many fronts. The above World index dropped over a third from its February peak and only started a slow recovery following the extreme monetary and fiscal support actions taken to avert a structural global economic collapse.

Economic lockdown measures were tightly managed to both contain the spreading of the virus and to try getting economies going again, with varying degrees of success. Some better news on both fronts started filtering in as the Northern Hemisphere Summer arrived, bringing some hope that the worst of the virus situations may have been left behind.

Following the turbulent Spring and Summer in capital markets, investors were served a cocktail of good news towards the end of the year. The third quarter US reporting season produced much better than expected results, the US election delivered a much closer than expected outcome and then, in less than a tenth of the normal development time, three successful vaccines were announced. These factors supercharged the traditional year-end equity rally. Against almost all odds, off an already high 2019 base for some investors, they enjoyed another strong equity market last year.

2020 is engraved in the annals of history as the year of COVID-19. Those investors who held tight through the year were rewarded. Those investors who were positioned in quality businesses with a sustainable growth orientation were rewarded even more so during the eventful GVC year.

ECONOMIC OUTLOOK

Despite the dire economic circumstances GVC caused, the economic outlook for 2021 holds good promise. Clearly, it should be relatively easy to deliver growth against a very low base, and a positive direction of travel is already in place. Along with this, we are assured of continued fiscal and monetary support 'as long as it may take' in all of the most important economies. China's economy has already recovered well, while the new US administration is expected to do all in its power to stimulate the economy.

The importance of getting out of the GVC and back on a normal economic track cannot be overstated. The good news on the vaccine front is therefore most welcome. We should, though, be conscious that varying degrees of economic lock-down measures may well continue to be necessary for a major portion of the first half of the year and that we can only look forward to a more normal economic environment from late Spring.

All said, the global economy seems to be heading for a welcome V-shape recovery. This is clearly a much better outlook than the U, the W and especially the L-shape recoveries many had feared we were heading towards. We have a wonderful world of outstanding scientists to thank – they are bringing us vaccine solutions within a record time.

Whilst we expect a strong economic recovery in 2021, the longer-term outlook remains relatively muted in our view. We expect continued growth for some time at sub-par levels in most of the largest economies, constrained by the high government debt levels caused by GVC.

INVESTMENT OUTLOOK

We consider the following as the main themes in the above context:

1. Interest rates may have turned the corner, along with inflation expectations. At this stage, this is a positive capital market indicator as it reflects the aversion of a doomsday economic scenario that many feared. As indicated in the previous paragraph, we do not yet see much economic reason to fear a run-away interest rate cycle.
2. The weakening Dollar is supportive of the global economy, including Emerging Markets, and also the US. Given the relatively weak fundamental economic circumstances in the rest of the world, it may not be necessary to yet fear a collapsing Dollar.
3. We expect many quality businesses will post strong earnings results as their revenues recover. Many businesses have cut cost structures to the bone through GVC, and are slow in taking those costs back on. Economic recovery may therefore support strong operational gearing in many businesses.
4. We have concerns about a potential bubble in a portion of the capital markets, especially around some blue-sky unprofitable technology titans, IPO's (Initial Public Offerings) and SPAC's (Special Purpose Acquisition Companies). They attract vast amounts of money.
5. Investors have to make sure their valuations are not stretched and 'in thin air', mainly based on low interest rates. Our valuations have all along been based primarily on a fixed discount rate.
6. GVC has structurally affected many businesses, for some in a positive way, and negatively for others. Some of their 'futures have arrived much earlier', while the demise of others has been accelerated. Our stance is clearly to focus only on the former.
7. We guard against the potential complacency some market participants may develop in believing that we will imminently return to a normal economic growth path and that 'everything will soon be back to normal'. We are rather in the 'new normal' school of thinking.
8. Some investors may struggle to understand changes in some valuation levels that GVC caused and may mistakenly sell future winners because of apparent current high valuations compared to historic norms.
9. It is not prudent to simply buy 'the market' rather than specific future winners. Astute stock selection is currently absolutely critical to ensure solid future returns.
10. It has traditionally been a good time to be invested during the early part of a positive economic cycle.

We believe we are structurally only halfway through an equity bull market. As before, corrections will continue to happen within the bull market, and these timings are impossible to forecast. We believe investors can rather look forward to being able to buy more structural winners at lower prices.

INVESTMENT THEMES

The investment road is littered by those with short-term horizons. It is a much safer approach to adopt a time horizon of more than five years when considering to buy a particular business. COVID-19 is accelerating many structural business dynamics, and it is offering some investment opportunities much earlier than previously thought.

We relentlessly adhere to our investment philosophy of owning only high quality sustainable growth businesses to hold for the long term, and remain very valuation conscious. The strategy's holdings are not adjusted for short-term economic cycles or ever-evolving investor preferences.

Our Global Best Ideas Equity strategy invests in exceptional businesses and is well exposed to the following structural investment themes and companies:

- **FUTURE ARRIVING EARLY**

  PayPal and Amazon (and many others') futures are in process of arriving two or more years early, without all of the usual necessary investments required to attract all those new clients. Their future profitability therefore also arrives earlier, and their share prices have to reflect that. The main issue is that we believe their further growth trajectory continues from here. As more good things usually happen to good businesses than to others, **PayPal** has recently introduced cryptocurrency settlement services with an immediate uptake and strong client engagement. **Accenture** also enjoys record order book growth from clients that has accelerated their technology investment programmes.

  Whilst the high street is structurally damaged, those businesses that have developed their online capabilities well are in process of taking permanent market share. Most of us are expected to continue buying online to the benefit of consumer businesses like **Nike and Estée Lauder.** They should also enjoy better margins with direct sales replacing those through wholesalers and retailers.

  We believe the global technology revolution to be only halfway through its development. The use of data is already exploding exponentially and has a long way still to go. The use of semiconductors is following suit, and it is striking how those shares remained strong through the GVC recession, contrary to previous recessions. Whilst rapid change in semiconductor technologies makes it difficult to identify structural winners in the industry itself, the companies supplying software design software to leading R&D engineers at those semiconductor companies benefit directly from the industry's structural growth, with **Cadence Design Systems** as example.

  Continuing on a data management theme, those businesses with the best libraries of historic data on which strategic business decisions are made clearly have a huge competitive edge. **Verisk Analytics** assists the insurance industry in pricing their risk. In a different form, **Intuitive Surgical has** built an extremely valuable databank from developing robotic surgery over more than twenty years.

- **FOCUS ON HEALTH CARE**

  As COVID-19 re-introduced us to some phrases (e.g. furlough, tier, distancing) it also reminds us thoroughly of mankind's ingenuity and not to take our health and longevity for granted. The renewed focus on better health care is expected to continue for long with businesses like **Intuitive Surgical** in surgical robotics (the 'Tesla of Health Care'), **Edwards Lifesciences** in cardiovascular treatments, **Stryker** in joint replacements and **Thermo Fisher** in scientific laboratory equipment leading examples. We expect particularly strong results following the delayed opening of hospitals to resume numerous postponed procedures. Mankind's relationship with their pets has also been cemented even further, offering animal pharmaceutical businesses like **Zoetis** even greater structural growth potential.

- **HUMAN NATURE**

  A very interesting reminder from the GVC is around mankind's nature of appreciation and appeasement, which is often expressed through gifting of luxury or quality goods. These items are often bought on holidays and travels. At the start of the virus crisis, many investors expected luxury good sales to collapse and then to make only a very slow recovery. They therefore dumped their shares in companies such as **LVMH**. It actually transpired that the gifting or buying of a luxury item is even more appreciated than before and has become an even more 'touch of the human soul' factor. COVID-19 has re-awakened this consciousness.

We consider numerous further structural investment opportunities. Of course, there are also numerous short-term cyclical opportunities, but we have absolutely no idea how long these legs may be or when to sell them. Over the past ten years there have been eight such opportunities, with the longest one lasting less than a year. With real US rates currently at a forty-year low and in negative territory, these cyclical prospects may be only temporary. We much rather invest for sustainable organic growth with our eye on the horizon rather than the proverbial next corner, and therefore having the investment odds on our side.

IN SUMMARY

Our investment philosophy has withstood the most severe GVC test well. COVID-19 has assisted in creating further structural investment opportunities. We hold outstanding franchises. We will continue to refine the portfolio and plan to keep investing inflows.

We are grateful for all your support.

With kind regards

Gerrit Smit
Partner – Head of Equity Management

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