Manager's Letter
3rd Quarter 2019

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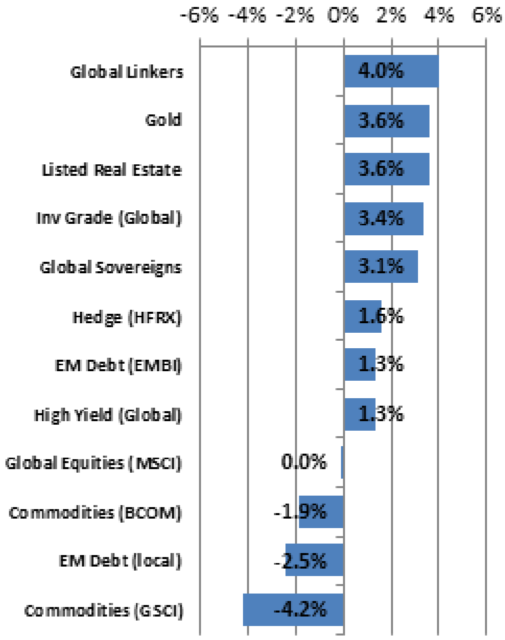
The backdrop for investing in Global equity markets last quarter remained a difficult mix of slowing global growth, trade tensions and supposedly maxed-out Central Banks quantitative monetary stimulus. For the first time this year, riskier assets (such as equities) performed less well than safe assets. Gold, Global Investment Grade bonds and Global Sovereign bonds, topped the multi-asset performance list. Commodities and Emerging Market local debt were at the bottom of the pile. Global Equities were largely unchanged over the period. The lack of movement in the aggregate index hides a more vicious rotation beneath the surface. Safer assets performed as global economic growth continued to slow in 3rd Qtr to levels near the 2018 lows, leading Central Banks to step forward with more 'accommodation', with the Federal Reserve, ECB and Peoples Bank of China all going down the policy easing path and the Bank of Japan potentially set to follow. Falling bond yields helped to support global equities with US Treasury Bond 10 year yields falling 0.28% to 1.73% - markets are still policy and discount factor reliant. Oil gyrated wildly, but Brent and WTI ended to the quarter down 8% on fears of slowing growth and oversupply. The US$ outperformed every G10 currency in 3rd Qtr. Given the performance of bonds, it is probably not a surprise to see in global sector performance, Global Utilities (+5.8%) and Consumer Staples (+3.5%) as the best performers, Energy (-6.7%) and Materials (-4.2%) underperformed.

Cross-asset performance – Q3 (US$, total return)



Source: UBS

The background of rising global trade tensions has been ever present this year and dictated much of the other reactions around the world. In the face of this uncertainty, confidence in future economic growth has collapsed with many indicators at lows not seen since the global financial crisis. Weaker exports and lower capital expenditures have been seen across the globe with China, Japan, Germany and Korea being the worst affected. As is usual in these periods of worry the US dollar tends to strengthen as the global reserve currency along with gold. The weakest link in the emerging market currency was the Argentina Peso, already under strain from the high US Dollar, it crumbled when the Presidential primary results were announced with a Peronist majority, the currency collapsing 33% in the following days. Adding to emerging market woes was an ongoing banking crisis in India, despite corporate tax rates being slashed 10%, the intertwined debt issues in some of the conglomerates is proving painful as it unwinds. Completing the bleak picture was the escalating tension in Saudi Arabia as its vital oil installations were attacked by what appears to be a state 'actor'. Oil prices reacted briefly but our sense is this is not the end to this geo political chapter.

On a stock specific basis, several of the strategy stocks registered good news over the period: **Aimmune Therapeutics** had its peanut allergy drug approved by the FDA. **Wandisco** had its software solution embedded in Microsoft's Azure cloud offering. **Ceres Power** announced a JV with Korea's largest fuel cell company, Doosan. **Seeing Machine** and **IQE** both announced further contracts win. On the more negative side, the issues in Argentina hurt **Banco Macro**, Indian banking issues were upper most in peoples mind for **Indiabulls** and a "salacious" short report made **Burford** a volatile investment.

Equity markets have been dominated by thematic investing in recent years with an increasing weight of money being channeled into this area. So called 'momentum' or 'growth' has been particularly popular, the belief being those companies that are considered structural winner will continue to perform[1]. While a lot can be said for this, it has led to some significant mispricing and valuation differentials. Some high profile new and proposed new listings, such as Uber, Slack and WeWorks have become victim to the realisation

[1] *No performance guarantee*

that revenue momentum is not everything and a return on invested capital is required at some stage. In the last few weeks this strong trend has reversed somewhat with investors starting to look at Value and Smaller market capitalisation equities as potentially providing a better risk/return profile[2].

Value vs. Growth, Small vs. Large – US Market

Source: Crédit Suisse

Outlook

The election cycle for the Presidency of the US means that the coming year will probably see further hardline policies against Chinese/European imports, Iranian aggression and immigration issues as the incumbent tries to burnish his credentials with his electoral support. The slowdown in growth caused by this will likely require more aggressive monetary easing by the Federal Reserve. As we reach the end of central bank capacity to ease monetary policy further, we expect Governments across the globe to start deficit spending particularly on infrastructure as a way of supporting economic activity. The disruption of Brexit has caused investors to flee the UK equity market. This has given rise to individual situations where companies' growth prospects are not being reflected in their valuations as many are not reliant on a UK domestic market for their sales. Overall world equity markets are exhibiting pockets of good value that over time will be interesting areas of investment; areas such as renewables, auto safety technology, semiconductor technology and areas of healthcare.

[2] *No guarantee of results*

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