Evenlode Investment View

June 2017 - Twas Ever Thus

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Summer is upon us, and fundamental company news has slowed to a trickle over recent weeks. Investor eyes have instead turned from the 'micro' to the 'macro' with plenty of political and economic developments to consider.

Most notable for British-based investors was the UK election and the hung parliament it produced, which flew in the face of consensus expectations for an increased Conservative majority. In my view this result won't have a significant bearing on the outlook for the companies in the Evenlode portfolio given the resilient, global nature of their business models. However, the weakened political mandate in the UK is likely to create plenty of 'noise' over coming weeks and months, and we'll therefore be alert to opportunities that may result from this incremental uncertainty. In particular, there are several excellent, domestically exposed businesses in the Evenlode investable universe which could become new holdings if valuations and dividend yields improve somewhat.

In terms of the global economic picture, leading indicators remain nonuniform with conditions continuing to improve in Europe, remaining very varied in emerging markets, and deteriorating in both the UK and the US. Partly due to this disappointing US data, the 'reflation' narrative that developed at the end of last year, regarding a potential acceleration in growth and inflation (particularly following the US election) has also dissipated somewhat. Interest rate expectations, energy and commodity prices have moderated in sympathy with these developments (oil, for instance, is now down more than -20% since its February peak and iron ore down more than -40% since its post-US election high).

Self-Sufficiency

So here we remain, nearly a decade on from the Great Financial Crisis, with the signature motifs of the post-crisis world - low growth and low inflation - continuing to cast their shadows on the corporate world. Meanwhile, innovation continues at a pace, with implications that spread to pretty much any sector of the economy one can think of. New businesses with new ways of operating are challenging industry incumbents and as a result adding to deflationary trends. Look no further than Amazon's purchase of Whole Foods last week – an event symbolic of both of these trends*.

With this backcloth of disinflation and disruption, companies need to be self-sufficient - they can't rely on a 'rising tide that lifts all boats' given such a patchy economic picture. Equally, even companies operating within the most stable, rational industries need to move with the times, continue to evolve their business models and adapt to changing technology and new entrants.

Twas ever thus! - you might accurately remark. I've just read *Chocolate Wars* by Deborah Cadbury, which traces the chocolate industry (Cadbury's, Rowntree's, Hershey, Lindt, Nestle et al.) from its roots in the nineteenth century through to the present day. It's a fascinating read, and a reminder that even for an industry as slow-moving as chocolate, there has been plenty to cope with and adapt to along the way: the advent of mass advertising, the invention of highly refined chocolate powders, fondant, milk chocolate, new entrants (the upstart Mars bar, for instance, hit the British market in 1932!), and consolidation as the sector became increasingly global in nature.

It's easy to look back with rose-tinted lenses, but 19th Century capitalism was just as cut-throat and unpredictable as 21st Century capitalism, and the temptations of short-termism just as human then as they are now. Whilst managers of today's publicly listed corporations confront a different flavour of challenges to those that business leaders such as Quaker capitalists George and Richard Cadbury faced, there's still a lot to be learnt from these Victorian pioneers and their holistic attitude toward business development, not least their:

- obsession with product quality.
- relentless focus on pleasing the customer.
- consistent approach to investment in R & D, staff and facilities (nicely symbolized by projects such as Cadbury's Bournville).
- open eye to expansion into adjacent markets and new innovations. Cadbury's expanded into Africa, for instance, with a single 'traveller' (the company's name for salespeople at the time) in 1886 when Harry Gear set sale for Capetown, and was joined shortly after by E.B. Brown, who requested the whole of southern Africa as his 'patch'. As Deborah Cadbury puts it, *traversing wide tracts of land on horseback under a meltingley hot sun, he went where no confectionary salesman had ever been, carrying a stock of cocoa and chocolate wares that had never been seen before in Africa and blazing a trail from the Cape to Northern Rhodesia*. Whilst emerging market distribution networks have moved on from 1886, we continue to appreciate the investments that many Evenlode companies continue to make in building their presence in high-growth markets around the world.
- prudent approach to financial management.

Above all, these factors exemplify a mindset that consistently puts the horse of long-term investment (and deferred gratification) ahead of the cart of today's profit stream.

Returning to 2017, the current macro-economic environment does not change the fact that steady investments to improve product quality, innovate, adapt, keep customers happy and expand addressable markets remain vitally important for business success. These developments, often incremetal, won't typically find their way into the news headlines in the way that political shenanigans, central bank decisions, or the latest economic data points invariable do (and nor would they have in the 19th Century!). But they'll mean a lot more for cash flow and dividend growth over the long-term. We remain encouraged by the number of market-leading British businesses that continue to invest in this way, and have had several conversations with management teams over recent weeks in which we have stressed our wholehearted support for this approach.

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Please note, these views represent the personal opinions of Hugh Yarrow as at 22nd June 2017 and do not constitute investment advice.

*This acquisition represents another step for Amazon, (a disruptive gorilla of a company - the world's fourth largest company despite being founded in the mid-1990s) in its move into the US grocery market. It brings the technology company head-to-head with entrenched food retail incumbents such as Wal-Mart, an encounter whose net result that presumably must result in further deflation for the vast US food sector.