

Evenlode Global Investment View

November 2022 – Results, Part 2



The commentary below applies to both the TB Evenlode Global Income and Evenlode Global Dividend portfolios. Market data is from FactSet and FE Analytics.

When we see PepsiCo's results pop up in the EDDIEⁱ Events Calendar, we know results season is about to begin. Using PepsiCo's rapid reporting as the start point in early October, as of the time of writing, 90% of the Global Income portfolio has reported in the latest round, and the average revenue growth has been 7% year-on-year. Results season gives us a snapshot of the global economy from the perspective of its engine, companies. Here are some of the themes we have noted:

Consumer behaviour starting to change

We invest in companies that we judge to have strong pricing power, where price is not a primary factor in purchase decisions. Results over the past couple of years have shown that for the consumer goods companies we own, volumes have remained solid despite large price increases to end-consumers in response to cost inflation, a good indicator of pricing power. Companies such as Unilever, Nestlé and PepsiCo, are only now beginning to see signs of changing consumer behaviour. While not material, management are noting signs of trading down and private label (e.g. supermarket own brands) taking some share in select, less differentiated, categories.

This is not unexpected. What we consider to be important for the long term is the ability to continue to invest behind brands irrespective of market conditions, choppy or calm. We are reassured by these companies' continued demonstration of strong cash generation, limited capital intensity and good balance sheets, key factors we look for in our process by design, ahead of time.

In the upper echelons of consumption, positive trends are continued unabated. LVMH, owner of market-leading luxury brands such as Louis Vuitton and Dior, posted another quarter of strength (+19% organic growth) despite ongoing challenges due to lockdowns in China (where revenue was flat). While management acknowledge that they are not immune to an economic slowdown, they noted that historically the impact is small, does not last long and strong brands emerge stronger in the recovery. L'Oréal, the market leader in beauty and skincare, and seller of many 'little luxuries,' saw no signs of trading down or slowing consumption.

Tech investments maintained

Companies in all industries kept up the pace of investments into 'digital transformation,' as consultants like Capgemini like to call them. While slightly slower than the first half, Capgemini's orders rose at a solid +13% on top of a large prior-year figure. Publicis and Omnicom, global marketing agencies, saw high growth in digital products and services like Publicis' Sapient (consulting, +18% organic growth) and Epsilon (1st-party data, +14%). The traditional marketing parts of the business also performed well, evidence that the macroeconomic environment is yet to lead to meaningful, widespread marketing cuts. Microsoft, provider of enterprise software and cloud services, is wedded to the long-term growth of technological adoption in all industries. It again posted solid performance, as Azure cloud revenues grew +42%, even if the market has deemed that Microsoft's value is less than

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it was in January. While small business and consumer-related revenue weakened, demand for enterprise software, the bulk of Microsoft's business, remained. Tech investments can improve operational efficiency, important in volatile environments in the short-term. They can also enhance competitive advantages in changing markets, important for the long-term. There are many examples of portfolio companies materially investing in technology for both the short term and long term, such as Clorox, adidas and eBay, all to the benefit of others like Microsoft, Capgemini and Publicis.

Cash flow volatility remains

Demand spikes, supply chain disruption and inflation have resulted in a more volatile couple of years than 'normal' for companies, and for the day-to-day cash they use to operate, which in aggregate is known as 'working capital.' The recent environment has in some cases caused large swings in the amounts and value of working capital businesses are holding through time. In turn, swings in working capital contribute to swings in cash flow. C.H. Robinson, a US-based freight forwarder, earn their chops in volatile markets, but cash flow has been negatively affected by the rapid and large increase in logistics prices. This reversed in the most recent quarter. In Q3 Robinson generated a record \$626 million of operating cash flow compared to an outflow of \$74 million in the same quarter last year. The \$700 million difference was driven by working capital, reducing by \$359 million versus Q2 as costs declined, compared to an increase of \$412 million last year as costs were increasing. Transport and logistics costs have come as down as rapidly as they rose. For Fuchs Petrolub, a specialist lubricant producer, the story is very similar, but their primary costs have moved more slowly. Their working capital is linked to refined and processed 'base oil,' with a price that lags the crude oil price by a few months. Due to high demand and restricted capacity, costs remain high. However, Fuchs have successfully been able to pass through these costs to customers with minimal impact to volumes, and have a strong balance sheet that enables them, much like C.H. Robinson, to handle volatility.

Where does that leave us? From the latest snapshot, it is clear that volatility remains, but companies with pricing power and the ability to reinvest behind their structural competitive advantages are managing well in the short term, while positioning themselves to benefit from opportunities and manage risk in the long term. This resiliency is valuable as we look to further uncertainty ahead. There are early signs that the worst of input cost inflation is abating, and supply chains easing. That is not to say things might not go the other way, but is no doubt welcome while it lasts. Meanwhile in the equity market valuations look more comfortable than they did at the start of the year, particularly in dollar terms, providing more of a margin of safety for long term equity investors.

An interesting five years

We recently celebrated the fifth anniversary of the Evenlode Global Income strategy, and to say the least it's been an interesting time to be investing in global equities. From benign economic beginnings the coronavirus pandemic struck less than halfway into the fund's life so far, and we learned to manage remotely amid a sharp market downturn and a subsequent protracted bull market. Now we are back to seeing companies and clients in person, in the midst of economic difficulties and a weaker market environment.

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We will pick apart our experience in the five-year life of the fund in a future investment view, looking at our hits, misses and learnings from this fascinating time. For now, we would like to extend our gratitude to all of our clients and business partners who have been great supporters of the fund and our efforts from its inception. As ever, please do get in touch with your thoughts and questions, and we look forward to the next five years of serving you.

Ben, Chris, Bethan, Rob and the Evenlode team

30 November 2022

Please note, these views represent the opinions of the Evenlode Team as of 30 November 2022 and do not constitute investment advice.

Where opinions are expressed they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice. This document is not intended as a recommendation to invest in any particular asset class, security or strategy. The information provided is for illustrative purposes only and should not be relied upon as a recommendation to buy or sell securities.

For full information on fund risks and costs and charges, please refer to the Key Investor Information Documents, Annual & Interim Reports and the Prospectus, which are available on the Evenlode Investment Management website (<https://evenlodeinvestment.com>). Recent performance information is also shown on factsheets, also available on the website.

Past performance is not a guide to future returns. The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Fund performance figures are shown inclusive of reinvested income and net of the ongoing charges and portfolio transaction costs unless otherwise stated. The figures do not reflect any entry charge paid by individual investors.

Current forecasts provided for transparency purposes, are subject to change and are not guaranteed.

Source: Evenlode Investment Management Limited. Evenlode Investment Management Limited is authorised and regulated by the Financial Conduct Authority, No. 767844.

ⁱ EDDIE: Evenlode Database for Direct Investment in Equities, also the name of Evenlode's mascot, Eddie the Otter.