Evenlode Global Investment View

February 2020 – On Revenues and Resilience

EVENLODE
GLOBAL INCOME FUND

The world in 2020

The big global news of the moment is, of course, the outbreak of a new coronavirus, or COVID-19. We are collectively receiving daily updates on the number of new infections and, sadly, deaths, particularly in China where the outbreak originated. There has been an unprecedented public health response, and time will tell how long the local efforts alongside global actions to contain the virus will take to bear fruit.

We are now starting to see the effects of these necessary actions in the world of business. The Chinese economy is itself a source of demand for goods and services, and with parts of the country unable to operate as normal there is a commensurate inability for companies to sell their wares. There could be a broader effect too, as consumers and businesses become more cautious. Apple has warned that sales to Chinese consumers will be lower for example, and it seems likely that demand will be muted for many firms for some time to come.

The case of Apple, a former holding in the Evenlode Global Income fund, highlights the Chinese economy's central position within the world's supply chains. Global sales of iPhones will be constrained because the firm's Chinese partners, notably Foxconn, are unable to produce them. More broadly, China accounts for around a third of chemicals production, so even those with manufacturing bases in other geographies could see detrimental effects. We have seen warnings of disruption from a diverse range of industries, from Medtronic in medical devices to Relx in the world of trade exhibitions. So far business continuity plans have meant that disruption has been relatively limited, and many will be hoping that the impact will be manageable in the medium term.

Away from the outbreak, companies in the Evenlode Global Income investable universe have generally been reporting steady progress in revenues, profit and cash flow. There are some that are seeing a more generalised cyclical downturn, such as US logistics firm C H Robinson and French advertising company Publicis. Networking equipment and software provider Cisco is seeing a weaker demand environment as decision times are being stretched due in part to the rollout of 5G mobile infrastructure. Economically sensitive businesses make up a relatively small part of the Evenlode Global Income portfolio, but most firms have a cycle of sorts. In an upswing are the pharmaceutical giants such as Roche and Sanofi, where new therapies in oncology and immunology are driving growth, amongst others. Microsoft is also currently riding the wave of a transition of computing to the cloud.

Most of the portfolio is, though, rather less exciting both on the up and the downside. Businesses as broadly based as Intel, P&G, Omnicom, Hugo Boss and Quest Diagnostics are posting steady low-to-mid single digit revenue growth and profit growth in line with or a bit better than that. This suits us and the Evenlode investment approach, and indicates that companies are generally well-placed to weather temporary impacts such as the coronavirus; whilst there may be a headwind from that particular issue, it is unlikely to be an existential threat to these companies in the long run.

Long term resilience

The coronavirus story is yet another illustration of the fact that negative things can and do come along in the world of business. One of the reasons we look for resilient businesses using relatively low levels of debt to fund their activities is so that the portfolios we manage can take the knocks along the way. We don't claim to have any great prescience on specific 'macro' goings on, but as we often say we want businesses to be as insulated as possible from a broad range of scenarios. This desire is really a way of saying we are aiming to manage risk within the portfolios that we look after on behalf of our clients.

Part of the current zeitgeist is that consumers, businesses, governments and investors are looking more seriously at long term risks, specifically those that are caused by human (and therefore their own) activities. Whilst we believe that the portfolio of companies that we have assembled to form the Evenlode Global Income portfolio are resilient to a broad range of futures, part of their resilience will ultimately come from a collective action to tackle some of the world's most difficult problems. In particular, the issue of anthropogenic climate change has risen a long way up the corporate agenda. Businesses are likely to be affected in the future either by physical costs from weather events, or governmental action to force a change in behaviours before a change in the climate (what the UN calls the 'inevitable policy response'[i]), or both.

We believe that investors have a part to play in assessing the risks from a range of sources and encouraging businesses to manage those risks appropriately, including those presented by climate change. Our latest Responsible Investment Report details our work in this area over the last year and is available on our website for interested readers. We hope that our efforts will help protect and enhance the value of our clients' assets in the long run, and in a small but meaningful way contribute to the broader movement towards managing some unavoidably global risks.

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Please note, these views represent the opinions of Ben Peters and Chris Elliott as of 20th February 2020 and do not constitute investment advice.

[i] https://www.unpri.org/inevitable-policy-response/what-is-the-inevitable-policy-response/4787.article