

# Evenlode Global Investment View

April 2020 – One Quarter Down

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We're one quarter through 2020, and it's been a quarter quite unlike anything we've seen. Just six months ago few risk registers would have had an entry entitled 'complete shutdown of large parts of the global economy', and even fewer would have had a meaningful probability pencilled in beside it (except perhaps those of a few epidemiologists). However, that is of course what has happened.

Having reached a quarter's end, we are due to report on the performance of the Evenlode Global Income portfolio. This is set out in detail below, and unsurprisingly given the news headlines, it has been a negative period for returns. Before giving detail on returns we will discuss the broader context of the coronavirus crisis in order to set the scene, and before that we would like to offer our thanks for the extraordinary effort that governments, policymakers and, importantly, healthcare workers and supply chain operators are going to in order to support businesses and individuals, for which they should be applauded.

We have no expert insight into how long the effects of the pandemic will last for, but it is our assumption that the crisis will develop in stages. First, the crisis will pass through an acute phase within some months or perhaps quarters. Then there will follow a longer period during which a normalisation will occur in supply chains, in demand from consumers and businesses, and in the withdrawal of state aid and central bank policy actions. This may sound vague in the near term, and that reflects the high degree of uncertainty that we see in the markets and global economy. As long-term investors in businesses however, forming a rough view of the future helps us to remember that this crisis, like others, will pass, and also helps us to consider whether there are any long-term implications for companies as a result.

## **Characterising the pandemic's impact**

Our work following the escalation of the novel coronavirus outbreak into a global pandemic has focused on assessing portfolio firms' ability to weather the storm and come out of the other side stronger. No business is immune in the near term, and some are more affected than others. Companies whose business is built around people travelling and getting together in the same location have been hit hard. Disney's parks and resorts are shuttered and AB InBev's beers are not being poured in pubs and bars in large parts of the world. Others are faring better, whether because of the increased demand for IT equipment and services required for home working (Intel, Microsoft), or because they provide something useful in the fight against the virus (Dettol from Reckitt Benckiser), or perhaps because they allow access to data and analysis that is required by other companies regardless of the outbreak (media firms Wolters Kluwer and Relx).

We have split the portfolio into three baskets of firms in order to assess the fund's exposure to the coronavirus crisis. The '*business almost as usual*' basket contains firms where operations will be relatively less impacted, particularly on the demand side. Most businesses will see some disruption to supply chains as various parts of the world go into degrees of lockdown, but many have been able to

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work around this with effective business continuity plans, and are more recently being helped by Chinese manufacturing coming back on line. Demand should be relatively robust for information technology companies, consumer goods firms, media businesses, and healthcare companies. There are naturally nuances for any particular business, but this *'business almost as usual'* basket houses around 60% of the portfolio.

The next basket is companies that have experienced more business disruption but have the strength to weather it, which we've termed the *'walking wounded'*. That strength often comes from a combination of good finances (i.e. low levels of debt) and diversified business operations. This basket contains a mix of service, technology, healthcare and consumer companies. For example Henkel, a large position in the portfolio, has consumer businesses that are relatively unaffected selling things like detergents and some products that are more affected like hair products for professional salons. It also has an industrial adhesives business that will see disruption to demand from some end-markets like the automotive sector, but in addition has other customers that are less impacted. The walking wounded make up about a third of the portfolio.

The first two buckets together account for the majority of the portfolio but there are a handful of companies that represent more *'severe cases'*, which total 6% of the fund. These businesses have more significant disruption to demand, and in a couple of cases have some debt to deal with too. Disney falls into this category, with 45% of operating profit last year coming from its parks and resorts. It has debt following its acquisition of Fox and has recently raised money in the form of more borrowings at long maturities in order to see through this downturn. Informa operates the world's largest portfolio of trade exhibitions, and again has some debt. It is this basket which poses the biggest risks to dividends, and where the focus of our analysis has been in ensuring companies will make it through to the other side of the crisis without resorting to asking shareholders for significant extra capital (which is where capital losses are potentially most severe). With a small part of the portfolio in this category we remain comfortable with the risk profile of the individual companies and the overall exposure of the fund, but we are clearly keeping a watching brief as the coronavirus situation develops.

## **On dividends and growth**

Those familiar with the Evenlode investment process will be aware that income is important to us as a manifestation of a business' success. In the Evenlode Global Income fund we seek a balance of income today and growth later and aim to grow the distributions to unitholders through time. The coronavirus crisis means that we must press *'pause'* on that ambition in the near term.

Whilst in normal times and even through normal downturns we would hope and expect the type of cash generative, high quality businesses we seek to be able to maintain shareholder payouts, these

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are far from normal times and this is no normal downturn. If the pausing, cutting or cancelling of a dividend is needed to ensure the long-term success of a company then that must be the priority, and at the current time there are plenty of companies that are likely to take such a prudent approach. We are supportive of that course of action.

Ultimately dividends will return, and their growth should continue. Should a company make it through this difficult period in good shape, its prospects may be enhanced by improved relationships with customers and an enhanced competitive position. As noted above, we don't quite know how long that will take to pan out, but if we think of an investment over a timescale of many years, if not decades, then the exact timing matters less.

As to the drivers of future prosperity and hence dividend growth, there is a good deal of discussion about how the crisis and the social response might change the prospects for particular industries or companies. Will people's enforced homeworking make them realise they can spend more time at home and less in the office? Will people be willing to go to crowded spaces or not want to take the risk? Will people fly less? Will we spend more time interacting via the internet? Will people buy more bleach as a matter of routine? How will buying patterns from healthcare systems change? These are interesting questions at any time but particularly now, and remain the subject of speculation. We think a good working assumption is that if people, companies or society wanted the goods and services before the crisis, they're likely to want them afterwards. Big shifts in consumer or corporate behaviour may occur, but they'll become apparent only through time.

Whilst there may be an acceleration or deceleration, trends like digitisation, data analysis, automation, efficiency, greater environmental awareness and a more socially-aware view of the world, particularly from a younger generation, seem unlikely to go away, even if there are other priorities right now.

## Fund performance - The headlines

The Evenlode Global Income fund's performance for the last quarter and over the last year is summarised as follows (all data from FE Analytics, total return and in sterling):

Total Return	Q1 2020	1 Year to End-March 2020
TB Evenlode Global Income - B Acc GBP	-15.0%	-2.9%
Comparator Benchmark – MSCI World	-15.7%	-5.8%
IA Global Equity Income Sector	-17.9%	-9.8%

Interestingly, for all the noise of the recent market sell-off, over a year the fund's price is down -2.9% and the benchmark -5.8%. We would obviously prefer to be delivering positive returns to investors,

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but these figures show how strong the performance in equities had been in the year preceding the recent sharp correction driven by the coronavirus pandemic.

In the quarter the fund outperformed its benchmark and the peer group of other funds, but not by a great margin.

## Which companies contributed in the quarter?

The table below shows the top five and bottom five contributors to total return (again all data from Factset in sterling):

Q1 2020 (%)	Total Return	Contribution to Fund Return
Roche Holding AG	10.1	0.3
Microsoft Corporation	7.1	0.1
Reckitt Benckiser Group plc	0.3	0.1
Wolters Kluwer NV	3.1	0.1
Apple Inc.	2.8	0.0
Henkel AG & Co. KGaA	-16.3	-0.8
Informa Plc	-48.4	-0.9
Western Union Company	-26.9	-0.9
Anheuser-Busch InBev SA/NV	-41.9	-1.1
EssilorLuxottica SA	-24.4	-1.2

There were few positive contributors in the quarter, and those that did avoid negative returns are in the *'business almost as usual'* basket. Roche is healthcare company that provides both pharmaceuticals and diagnostic equipment, so is perhaps a beneficiary of the current situation. Microsoft is seeing soaring demand for cloud and teamworking services (we're heavy users of Microsoft Teams at Evenlode), and Reckitt Benckiser's consumer health, home and hygiene products are in favour for obvious reasons. Wolters Kluwer is not perhaps so obvious but does provide software and data services to help stable industries like lawyers and accountants do their job, and also has products that aid medical practitioners. We disposed of Apple on valuation grounds in January and its stock has fallen in price since then, although it has continued to outperform the broader market.

There were conversely plenty of negative performers. Two to highlight that are in our 'walking wounded' and 'severe cases' baskets respectively are AB InBev and Informa, which we discussed above. Their impact was lessened by our low maximum positions, reflecting our acknowledgement of the leveraged nature of their balance sheets, but this did not completely deaden the blow. The most negative contributor was lenses and eyewear giant EssilorLuxottica, which is a significant position in

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the fund. Much of the frames and sunglasses business is retail and has therefore been impacted by the lockdowns, and social distancing affects optometrists as well as other areas of healthcare. It nonetheless remains a high-quality business that enjoys a great competitive position through its technical expertise and unmatched portfolio of brands, and so it is likely to make a full recovery in our view.

## Sector view

There are many ways to look at the performance of sectors within the portfolio. At its most basic we can look at the contribution of a sector to the overall performance of the portfolio, but we can also look at the performance against the fund's benchmark to get an insight into what's driving relative performance. Both are summarised in the table below which extracts sectors of interest and is ordered by contribution to portfolio return. The full table can be found in the note at the end of this report. Please note that the figures are before any charges and underlying trading costs are accounted for, as well as ignoring any trading effects.

Q1 2020 (%)	Portfolio Weight	Total Return	Contribution to Portfolio Return	Contribution Relative to MSCI World
<b>Selected sectors:</b>				
Financial Services	5.4	-18.1	-1.0	1.6
Energy	0.0	--	--	1.2
Consumer Defensive	22.1	-11.1	-2.4	0.3
Technology	18.3	-11.9	-2.1	-0.8
Healthcare	24.1	-13.7	-3.2	-0.9
Communication Services	16.0	-22.7	-3.8	-1.5

The sector performances relative to the comparator benchmark reflect once more the natural biases of the Evenlode investment approach. Financial services and energy are sectors where we don't generally find too many companies that fit our criteria of asset light, cash generative businesses that are price makers, rather than price takers. These sectors have not performed well in the quarter - in the case of finance because of its role in delivering the monetary and fiscal stimulus set out by central banks and governments, and in the case of energy because of the collapse in the oil price. This means they were both positive contributors when comparing the fund's performance to the MSCI World comparator benchmark.

Negatively, the fund's exposure to communication services was the biggest detractor to portfolio returns. This sector contains companies such as advertising agencies, which form the part of the

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portfolio which is most economically sensitive to the current lockdown. Given the sudden downturn it is unsurprising that they have underperformed, but we perhaps did not anticipate quite how quickly things would deteriorate. As discussed above, where we continue to hold businesses in this sector it is where we assess the risk/reward balance to remain favourable over the long term. Technology is an interesting sector, as the benchmark performed very well as companies that provide video conferencing and other remote working, home entertainment and internet shopping infrastructure benefit from the lockdown situation. The fund has some exposure to this through firms like Microsoft and Oracle, but business to business franchises like Accenture and IBM have fared less well in terms of market price performance, even though they have outperformed the broader market. The disposed holding in travel technology firm Sabre is also in this sector.

## Quarterly view

After strong performance in the prior two quarters, the fourth quarter of 2019 was a period of weaker performance, as the fund's price declined versus a moderate increase for the broader market. In 2020 to date the performance has been negative, but marginally better than the benchmark and the fund's sector of peers (all data from FE Analytics, total return and in sterling):

Quarterly total return – Last four quarters	Q2 2019	Q3 2019	Q4 2019	Q1 2020	1 Year to End- March 2020
TB Evenlode Global Income B Acc GBP	10.6%	4.7%	-1.2%	-15.0%	-2.9%
Comparator Benchmark - MSCI World	6.5%	3.8%	1.0%	-15.7%	-5.8%
IA Global Equity Income Sector	5.7%	2.7%	1.2%	-17.9%	-9.8%

## Looking ahead

This is clearly a time of great uncertainty. Our analysis has focused on recognising where there are acute situations in the Evenlode Global Income portfolio that require near term action, and on the longer-term prospects for companies after the crisis passes. Whilst that process washes through we are supportive of companies taking actions to protect their businesses and make it through to the other side.

We give thanks for the great efforts of front line medical, educational and supply chain staff who are keeping the global population as safe, well and happy as they can be during this pandemic. They are enabling us at Evenlode to continue to do our job of looking after our clients' savings, and we look forward to the time that lockdown passes and we can see you in person once again. We hope you remain safe and well in the meantime.

**Ben Peters and Chris Elliott, Fund Managers**

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Please note, these views represent the opinions of Ben Peters and Chris Elliott as of 07<sup>th</sup> April 2020 and do not constitute investment advice.

## Full list of sector contributors

Q1 2020 (%)	Portfolio weight	Total return	Contribution to portfolio return	Contribution Relative to MSCI World
Basic Materials	2.32	-23.57	-0.59	0.05
Communication Services	15.98	-22.70	-3.80	-1.54
Consumer Cyclical	4.34	-20.80	-0.94	-0.06
Consumer Defensive	22.06	-11.09	-2.42	0.29
Energy	0.00	--	0.00	1.22
Financial Services	5.42	-18.11	-0.96	1.57
Healthcare	24.14	-13.70	-3.23	-0.87
Industrials	5.49	-22.50	-1.34	0.24
Real Estate	0.00	--	0.00	0.12
Technology	18.29	-11.93	-2.07	-0.84
Utilities	0.00	--	0.00	-0.29

Sectors defined by Morningstar and the iShares MSCI World ETF is used as the benchmark.