Evenlode Global Investment View

March 2020 – Hold Tight

EVENLODE
GLOBAL INCOME FUND

"It doesn't matter whether it is a virus or social unrest or strikes or all of the different uncertainties or issues or challenges we've had, we certainly do not change our strategy to fit that issue"

Steve Ingham, PageGroup CEO

On discussing recruiter PageGroup's annual results and the impact that the new coronavirus outbreak might have on the business, CEO Steve Ingham sounded like a person after our own hearts here at Evenlode Investment. PageGroup is a holding in both the Evenlode Income and Evenlode Global Income funds, with one of the things we particularly like being the company's unwavering focus on building the business for the long term. Being in the recruitment sector (Page focuses on high-skilled, white-collar jobs), the firm is no stranger to cyclicality and manages the business accordingly. The balance sheet always has a surplus of cash, and when downturns inevitably come along senior managers are retained to ensure that market positions that have been hard won over a protracted period of time are not given up. Companies with such levels of cyclicality make up a minority of the Evenlode portfolios, but we are not completely averse to holding those that have the strength of business model and finances to ride the ebb and flow of economic conditions.

As equity fund managers we experience our own ups and downs, and managing portfolios that differ significantly from the market adds an extra layer of interest to the vacillations of the broader stock market. Over the last year the Evenlode Global Income fund has seen its own cycle, with strong performance relative to global equity indices in the first half, and weaker performance in the second. Unusually, the outperformance came in the upswing, and underperformance in the down, something that has happened from time to time in the longer history of the Evenlode Income fund but is not the norm. Things can move quickly though; in the very recent market volatility driven by the collapse in the price of oil the Evenlode Global Income portfolio is at the time of writing faring relatively well.

In periods of such volatility, both valuation opportunities and traps can emerge. However, much like Mr Ingham, the guiding investment principles that we use to navigate the market remain the same. The Evenlode investment process is by design long term in nature, and we will continue to apply this strategy whatever the environment. The aim is to find businesses that add value to their customers' lives, that consistently generate cash from their operations, and are likely to continue to do both long into the future. We then invest in a selection of those businesses at prices that we believe make sense compared to the long-term business fundamentals, with due consideration for diversification by geography, economic sector and business model. Combined with our bias towards less economically sensitive businesses, we think it's a sensible approach to balancing risk and opportunity over the long run.

In the near term we have both the oil-price shocks and the coronavirus to contend with. Equity markets have awoken to the possibility of global economic disruption and we have seen downside volatility, the awkward bedfellow of upside returns. Nobody really knows what will happen because of the outbreak; it will probably be negative, particularly in the first half of 2020, but analysis beyond that very high-level statement moves quickly into speculation. Given the difficulty of predicting the economic future, we prefer to insulate the portfolio against a range of outcomes and scenarios. We remain comfortable that the Evenlode Global Income portfolio holds companies that have the customer proposition and financial structure to achieve that aim. A beneficial aspect of the recent fall in equity prices is that the valuations on offer in the market look attractive in our estimation, welcome news for long term savers (a group that includes ourselves).

However, being long-term in nature does not prevent us from acting on new information, where there is a material change to the risks that a company faces. The new coronavirus outbreak is certainly a new fact, and one holding where we have felt our analysis needed to be modified is Sabre, an operator of a global distribution system for airline tickets.

Flights delayed

With travel restrictions in place in affected geographies (the whole of Italy has now been essentially quarantined in the most recent escalation), there is a strong prospect that these are applied in other areas looking to contain the spread of the virus. There's an understandable reticence of individuals to take the risk of moving around the world even if travel restrictions aren't put into force, and so companies that service the travel industry are an obvious place to look for negatives. Sabre is a US technology business who's largest division is operating the plumbing between travel agents and airlines. They are remunerated per ticket sold, so fewer tickets equals less revenue.

Whilst we don't know how long the coronavirus will cause problems for, it seems reasonable to assume that at some point in the future it will not be so much of an issue. At that point, air travel volumes may recover. Sabre's revenue will likely return and it will continue to do the steady-but-dull job of making sure flyers can buy tickets. On that basis, a temporary pause in revenue generation isn't too big a problem.

Unfortunately, the operating strength is complicated by the debt that Sabre holds on its balance sheet. A short pause in revenue and profitability is manageable. A longer break might not be. If debt ratios balloon, first the dividend could be at risk and then equity holders might be called on to reduce the debt burden. This would likely lead to a permanent loss of capital for investors and is very much an outcome we want to avoid.

Instead, we decided to sell the Evenlode Global Income fund's holding in Sabre. We sold at a loss, which is undesirable, but it's important to 'play the ball as it lies' and our analysis indicated the risk/reward balance had swung to a place where we were not comfortable continuing to hold the company.

With any luck Sabre won't run into a significant downturn – that would indicate a passing of the current situation. We will wait and see. If the financial situation of the company is improved over the coming months and years then we will revisit Sabre and play the ball from there too.

Holding Steady

There aren't many businesses that won't be affected by the outbreak, but the Evenlode Global Income portfolio holds companies that we assess to be well placed to come through in good shape, and we will continue to work to weed out the few that might not. We don't know what the short-term impact will be, but all of the businesses do jobs for their customers that their customers value. In many cases these jobs are mission-critical – healthcare companies like those in the pharmaceutical and medical testing sectors, or technology companies providing physical and software infrastructure, or media and data firms making business operations more secure and more efficient.

Over a longer time horizon such characteristics give these investee companies the greatest chance of prosperity. In the near term, lower market prices may make for some interesting opportunities. We haven't yet replaced Sabre with anything else, but we have options in our wider investable universe of high-quality global businesses. Those that haven't yet made their way into the portfolio have usually not done so because their valuations look relatively unattractive, but there are a number for whom the recent market action is making that picture change.

We will continue to report on any portfolio changes through time and will hold tight to the Evenlode investment process as we progress through this latest outbreak and on to the next phase for the global economy.

Ben Peters and Chris Elliott
Fund Managers

Please note, these views represent the opinions of Ben Peters and Chris Elliott as of 10th March 2020 and do not constitute investment advice.