

**Please note that the commentary is for the retail class of the fund.**

2019 was a year to make money. In fact, of the 38 asset classes tracked by Deutsche Bank, all were up on an annual basis – the first time this has happened since 2007 when the dataset began. In the face of inverted yield curves, ongoing US-China trade tensions, and Brexit drama, the stock market posted its strongest gains since 2009 and in the eleventh year of this bull market. On reflection, it was very hard for investors not to post gains. What a contrast to a dismal 2018, during which 31 of Deutsche Bank's asset classes declined.

The fund performed well in this environment, returning 3.8% in the fourth quarter (vs the benchmark return of 0.6%), bringing the full year return to 11.7% (vs the benchmark of 2.3%). Since inception, which is now over 9 years, the fund has returned 4.5% per annum (p.a.), 2.4% ahead of the benchmark, and also comfortably ahead of inflation. Years like this are beneficial to wealth creation. But after a sustained period of strong equity returns, declining interest rates, reduced tax rates, expanding profit margins, and rising valuation multiples, investors should, in our view, recalibrate return expectations lower. The conditions in place today are quite different to those in place a decade ago. We have no insight into short-term market moves but feel that absolute returns could very well be lower over the next ten years compared to the last ten.

Strong equity markets, combined with good stock selection, were the primary drivers of the fund's strong return in 2019. The fund's equity holdings delivered 39% for the year, more than 12% ahead of global equity markets which returned 26.6%. With an average equity allocation of 33.5%, equities contributed over 11% (far and away the bulk) to the fund's annual return. Our property stocks recovered in the fourth quarter, returning 4.9%. But the annual return was a fairly disappointing 3%. Considering the minimal risk carried, we are quite satisfied with the 5.4% fixed income return for the year, even though it lagged the benchmark by 1.5%. Prices for most fixed income assets have been pushed to very high levels, in our view, and we will continue to hold very little duration or interest rate risk until value emerges. More on this below. Finally, gold was a notable performer, increasing 18% for the year.

At quarter-end the fund was positioned as follows: Equity 30%; Property 7%; Infrastructure 1%; Commodities 5%; Corporate credit 10%; Inflation break-evens 5%; Government bonds 2%; and 'Cash plus' instruments 41%.

The fund's benchmark is USD cash + 1.5%. Although we will be held to our benchmark over time, our aim and intention in managing the fund has a number of additional dimensions:

1. Deliver absolute returns ahead of cash (and ahead of inflation in time);
2. Offer downside protection from equity market volatility, ideally preserving capital over a 12- to 24-month period (although this is not guaranteed);
3. Do not expose the fund to excessive risk, even if such exposures represent large asset classes which, in a normal environment, would be well-suited to a fund with this mandate (such as developed market government bonds today).

Executing on these additional dimensions over time will, in our view, not only lead to a satisfactory return outcome, but one that continues to be ahead of the benchmark.

We expand on three points below, which inform our portfolio construction and reflects key investment views.

**1. Equities are the core building block to deliver real returns over time**

We strive to fill the portfolio with businesses that have a strong competitive position in a growing market and are led by capable managers who allocate capital accretively. This strategy entails retaining earnings to fund high return on capital investments or returning capital to shareholders in the absence of such opportunities.

We believe that owning a share in such businesses is the best way to grow capital at rates ahead of inflation. Furthermore, our aim is to find a range of businesses that are fundamentally different on a number of dimensions, such as growth drivers, geography, foreign exchange, sector exposure and factor characteristics. This creates an uncorrelated portfolio mix. We also look to purchase these business interests at a discount to what they are worth when considering their long-term earnings power and a normal (i.e. not based on today's abnormally low debt costs) cost of capital.

Given the risk profile of the fund, the equity weighting in Global Capital Plus will be lower than in Global Managed, and total risk exposure (equities plus property) is capped at 50%. This portion of the fund will always have a trade-off between contributing to real returns, offset by the risk of price declines.

If we step back from our bottom-up research process and aggregate individual exposures, we often find clusters of value with similar characteristics. The areas where we are seeing opportunity span different regions, sectors, business-types and even 'factors'. We don't subscribe to a factor-based investment approach, and continue to uncover opportunities across a range of different factor types. These include:

- Global consumer franchises, including the world's largest premium brewer Heineken, the world's leading snack and confectionery business Mondelez, the second-largest footwear and sports apparel business Adidas, and the leading luxury goods conglomerate LVMH;
- Leading internet platforms in the US and China covering search, ecommerce, gaming, social, travel and classifieds;
- Tobacco, including Philip Morris, which owns IQOS, the leading smoke-free alternative;
- US and European financials firmly in "value-stock" territory, including a range of well-capitalised, strong banking franchises, trading on single digit price-to-earnings ratio (PEs);
- US health insurers, which we believe are high-quality compounders that have been discounted due to political noise;
- Cable businesses, which are driven by the explosive growth of broadband demand;
- Domestic UK businesses, which are heavily discounted following years of Brexit-driven uncertainty;
- Emerging market consumer-driven businesses, including two Asian insurers (Ping An and AIA);
- Music streaming, including Vivendi, owner of UMG, the largest music label;
- Aerospace, including Airbus, which is a duopolist in the structurally growing aerospace sector;
- Railways, which own irreplaceable transport infrastructure across the US;
- Alternative asset managers, including the world's leading alternatives franchise, Blackstone, which we have owned since 2011;
- Payments, including payment processors and credit card networks;
- Japanese drugstores.

These buckets account for the bulk of the equity exposure in the fund. Some we feel are quite significantly discounted, others more fairly priced for the quality of the business. Taken together, they aggregate to an undervalued portfolio that is fundamentally diversified.

**2. There is little value to be found in the fixed income space**

The Global Aggregate Bond Index covers \$57 trillion of outstanding debt instruments. Of this, approximately two-thirds is government or related debt, 27% is corporate, and the remainder relates to securitised instruments.

You will no doubt have seen the headlines relating to the amount of debt outstanding (c.\$12 trillion currently) with a negative yield to maturity, in effect guaranteeing investors a loss. For further context, the government portion of the Global Bond Index currently offers a yield to maturity of 1.1% with a duration of eight years. So, by purchasing the index constituents and holding to maturity one can lock in a return of just over 1%. Not only is the absolute return pitifully low, unlikely to even match inflation, but investors also risk meaningful capital losses should interest rates rise (a 1% rise, taking the rate to a still low 2%, would result in roughly an 8% capital loss).

We did however, initiate a new government bond position in the quarter, representing 1.5% of the fund. This particular instrument (an emerging market government) is anomalously priced in our view, offering an attractive absolute return, while at the same time yielding c.5% more than inflation. Real yields in most developed markets are 0% if not lower.

We also took advantage of the market's consensually benign view of low growth and inflation to buy inflation protection in the fund (currently just under 5% exposure). After more than a decade of low and declining interest rates, and low inflation, the market has become complacent about the level of future inflation. One of the biggest risks, however, to any portfolio that owns equity and fixed income securities is an upside inflation surprise. Such a shock would likely cause a recalibration higher of required returns, pressuring many asset prices. Going 'long inflation' when expectations embed a 1.6% inflation rate for 30 years feels like an asymmetrical risk-reward to us, and even more valuable considering the uncorrelated nature of the position to most other holdings in the fund.

Our corporate credit exposure (10% of fund) has declined slightly over the year as we sold into strength, given that credit spreads have almost universally declined.

In contrast to the Global Aggregate Index, our fixed income team continues to find higher-yielding instruments with significantly less risk. By way of example, the 41% of the portfolio invested in cash plus instruments is yielding c.2.8% with a duration of 0.2 years. This seems a more favourable place to wait out the current low-yield environment than the index.

We have, since inception of the fund, considered property investments as an alternative to fixed income. Exposure to property stocks remained steady (at 7% of fund) over the quarter. Prospective returns relative to fixed income still look attractive, but that is largely because fixed income yields are so low. In our view, absolute returns from today are likely to be lower than those delivered over the last decade. However, we are still finding a handful of undervalued stocks, and are also exploring opportunities in less well-covered sectors of the market, which have the potential to add welcome diversification to our property holdings.

We have also started building a small position in a handful of listed infrastructure businesses. These typically own long-duration (usually spanning many decades) real assets such as toll-roads and electricity grids, which operate in a framework where allowed rates of return are contractually agreed. As such, the expected return over the lifetime of the asset can be determined with a reasonable degree of certainty. We are mindful of the effect low interest rates (and costs of capital) may have had to prices in this asset class, so are moving slowly. But we also believe the prospect of adding another uncorrelated stream of return to the fund will, over time, further improve the ultimate risk-reward outcome for investors.

**3. Other idiosyncratic positions**

Outside of the traditional equity and fixed income asset classes discussed above, there are two other positions in the fund worth discussing. We believe both have reasonable return expectations and should pay off in different market environments to those in which the traditional asset classes would be expected to perform well - valuable characteristics for a multi-asset fund.

*i) Commodities*

During the quarter, we increased the fund's gold holdings and began building a new position in platinum. We consider the fundamentals of the platinum market over the next five years to be incredibly attractive. Platinum is priced at roughly half of its increasingly expensive sister metal – palladium – and we believe in time this differential will drive substitution into the cheaper metal.

*ii) Foreign exchange*

The US dollar has been in the ascendancy since the start of 2018, buoyed by higher growth and interest rate differentials as well the strong performance of US-based assets. More recently, the US-China trade disputes exacerbated these impacts as the manufacturing slowdown was more concentrated outside of the relatively insular US economy. While a case for the US dollar can still be made, it is becoming more difficult to articulate. The euro and yen are both arguably undervalued on traditional foreign exchange measures, and with their low interest rates, both have become funding currencies for carry trades. This means they are susceptible to a change in fortunes if the current backdrop changes. In the case of the euro, this could come about if the European Central Bank and eurozone were to adopt more expansive fiscal policies aimed at boosting growth. In Japan, the yen has traditionally been a beneficiary of more risk-averse moves in asset prices, which could be more likely after the recent strong appreciation in markets. Measures of policy uncertainty are high and global trade discussions, recent geopolitical developments, and any withdrawal of central bank asset purchases all potentially pose challenges to markets. However, across a broad range of asset classes, volatility is low. In the case of the euro and yen, implied volatility is at historically low levels (last seen in 2007 and 2014). In both prior instances, the underlying currencies subsequently saw strong moves. Currency options therefore offer cheap portfolio protection but also an interesting investment opportunity in their own right. We have taken advantage of these dynamics by purchasing options on the euro and yen, covering 15% of the fund, at a cost of 3 basis points per month.

Thank you for your continued support and interest in the fund.

**Portfolio managers**

**Louis Stassen and Neil Padoa**  
as at 31 December 2019