

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

The narrative around the short-term driving forces for global equity markets has not changed materially since the previous quarter, nor since the beginning of the year. Investors are still fixated by the anticipation of lower interest rates in the US and the ebb and flow of trade war rhetoric between the US and its major trading partners. During the third quarter, these variables resulted in essentially a zero-return generated by global equities. We did see the US Federal Reserve cutting rates by 25 basis points at its last Federal Open Market Committee meeting, but a slightly less dovish commentary surrounding the interest rate cut disappointed investors. On the other hand, there has been some reprieve in the tit-for-tat tariffs imposed by both the US and China, with implementation dates pushed out and negotiations continuing. The year-to-date benchmark index return (MSCI All Country World Index) of 16.2% speaks more to a low base from the fourth quarter of last year (the 12 months lagging return is only 1.4%) than to better news on the economic or corporate profits fronts. The three-year return of 9.7% p.a. is slightly above long-term averages.

The US equity market continues to perform better than its counterparts around the world. It has outperformed Europe by 6.5% over the first nine months of the year and by over 4% over the last 12 months. The performance of its financial sector relative to that of Europe, as well as the strength of the information technology (IT) sector in the US explains the majority of this outperformance. Japan had a better quarter in relative terms, but still lags the US materially over the longer periods. Emerging markets (EMs) continue to underperform their developed market peers, primarily as a result of poorer corporate profit growth and some self-inflicted economic pain. EM currencies by and large have actually been reasonably strong.

From a sectoral perspective consumer staples outperformed over the quarter, while the economically sensitive energy and materials sectors underperformed. IT and real estate were also strong. Over the last 12 months, utilities and real estate were the strongest outperformers, on the back of expectations of lower interest rates, with consumer staples also outperforming the benchmark index by almost 9%. Energy and materials were the underperformers, with healthcare also lagging as a result of proposals by Democratic Party presidential candidates to radically overhaul the US healthcare system.

The US dollar continues to strengthen against its major trading partners, causing more angst amongst the Trump administration about the competitiveness of US exports. The US dollar outperformed the euro by over 4% over the quarter, and by 6.2% over the last year. The Japanese yen was the only major currency that strengthened against the US dollar over the last year.

Your fund marginally underperformed its benchmark over the quarter. Over the last year, the fund has outperformed the index by 1.3%. Over three years, the fund return lagged the index by 2.3%. Over the last 12 months, major contributors to the strong relative performance included both cable companies Altice US and Charter Communications.

These stocks related as earnings marginally surprised on the upside, and investors reassessed their cash flow prospects as capital spending is projected to decline significantly into the future. We discuss these stocks in more detail at the end of this report. Other contributors included both alternative asset managers Blackstone & Carlyle (strong operational results and corporate restructurings well received by investors), Adidas (strong operational result and a rerating), Pershing Square (strong investment results and good capital allocation), and Facebook (strong results despite negative news headlines).

Detractors included Intu Properties (further deterioration in UK retail environment putting pressure on an overleveraged balance sheet), Aspen (derating on balance sheet concerns), British American Tobacco (further derating on industry concerns), L Brands (poor trading resulting in a further decline in margins), and American Airlines (poor operating results with some balance sheet concerns). While the issue of over indebtedness seems to be a common cause for underperformance, we believe most of these companies will be able to trade out of their balance sheet constraints. Intu Properties is the exception to this view, and the company is actively looking to address its balance sheet through asset sales and other means.

Both of our cable holdings, Charter Communications and Altice US, have strongly outperformed the market year to date, up 45% and 74% respectively. As the leading providers of broadband internet in the US, we believe cable operators are well placed to benefit from the continued shift of entertainment online. Data usage in the US is high, with operators disclosing average monthly household data consumption of 250GB. This continues to grow strongly.

A cable system can be compared to an electricity grid transmitting data from one point to another, and today most US homes have cable running past them, dug into the pavement many years before. Cable operators own advantaged infrastructure, with speeds of 1 Gb per second readily available, and operate in natural monopolies in most towns and cities, making them well-placed to benefit from the strong structural tailwind of rapidly increasing data demand.

The market has historically focused on cable's declining traditional pay-TV business, even though broadband internet is now the primary product sold into the home. Broadband is a must-have, sticky product for consumers, is growing its subscriber base strongly and contributes the bulk of cable earnings and almost all free cash flow (FCF) today. Pay TV's contribution to overall company valuation must not be overestimated. We believe the cable investment case remains underappreciated, with Charter and Altice USA trading on 2020 free cash flow (FCF) yields of 7% and 9%, respectively, and with strong growth in FCF expected. Both trade at material discounts to the market and we continue to hold them as core positions in the funds.

We remain excited about the prospects for our equity holdings, despite the macro concerns. Most of our holdings are generating a lot of cash and as such are more in control of their own destinies, despite what might transpire on the global trade front. We continue to find new opportunities as the market cycle violently swings from greed to fear in certain sectors.

**Portfolio managers**  
**Louis Stassen and Neil Padoa**  
 as at 30 September 2019