Please note that the commentary is for the retail class of the Fund.

Equity markets declined by 1% over the third quarter, with a weak September (down approximately 4%) ending a strong run of consecutive positive monthly gains since February this year. The global bond market was down by a similar amount (0.9%), bringing the year-to-date decline to -4%. Despite these price declines, the US 10-year Treasury bond yield is still low, at around 1.5%.

The Fund underperformed over the quarter, declining 5.2%. The return for the last year is a more satisfactory 13.1%, albeit 2.3% behind the benchmark. Over five years, the Fund has returned 6.6% p.a. (2.4% behind), and over 10 years has returned 7.8% p.a. (0.4% behind).

For the quarter, cash and commodity holdings were the primary contributors to return, while the Fund's equity holdings, specifically those positions exposed to China, were the primary detractors. Since November last year, various regulatory changes and investigations have been announced and carried out in China. It is likely that these changes are indicative of a more intrusive regulatory regime going forward, but the impact will vary by sector. Some of these regulations have similar objectives to regulations that are commonplace elsewhere globally, aimed at promoting fair competition, protecting consumers and safeguarding data. We think the intrusiveness of the various regulators and the resultant uncertainty has raised the hurdle rate for investing in China. But over the long term, we think China will remain a country with significant investment opportunities. We used the dislocations in the market to re-orient the portfolio to those businesses on the right side of regulatory change or where good businesses suffered price declines that meaningfully overshot our assessment of the regulatory risk. To do justice to this important topic, we will provide a comprehensive discussion on what has happened and our views in an upcoming *Corospondent* article.

Netflix was a top contributor to performance in the third quarter. Netflix is the world's largest paid streaming video platform, with over 200m subscribers worldwide. The company, led by visionary founder Reed Hastings, is extremely innovative and has shown the ability to disrupt itself to stay ahead of a dynamic market on numerous occasions – pivoting from rented DVDs to streaming in 2007, launching its first Netflix Original in 2013, and, more recently, its move into gaming, which we believe will bring significant benefits to already strong engagement metrics.

Netflix offers an unrivalled combination of global content production capabilities and distribution reach, giving it the ability to make and break great shows and movies around the world. The company has proven that good stories resonate globally, as evidenced by hit shows such as Narcos, Lupin or recent phenomenon Squid Game, and Netflix Originals now dominate its Top 10 viewing lists.

Netflix has long been considered the disruptor of the traditional pay-tv bundle. However, we still see a significant growth runway, driven by latent pricing power and strong subscriber growth in international markets. The US home market is often labelled mature, but we believe Netflix's pricing power is under-appreciated. Over 70m US households are still paying around $100 per month for a traditional pay-tv bundle. Against this backdrop, Netflix is an absolute steal, with an ARPU (average revenue per user) of $14.50 per month, and it will continue to be a beneficiary of accelerating pay-tv declines in its core market for years to come.

Netflix is no longer without streaming competition, but we consider it well-placed to be the streaming anchor in households around the world. With continued strong tailwinds from the global disintermediation of the pay-tv bundle, its subscriber base could double over the medium term, with above-inflation price increases. We expect earnings growth of over 25% per year over the medium term, with the company set to generate significant free cash flow going forward, as content costs begin to moderate off a massive $17bn base after years of accelerated investment. The Fund increased its position at prices below $500 earlier this year.

The Fund's aggregate exposure to North American railroads detracted from returns in the quarter. While we haven't discussed these investments in detail previously, our initial research work into the stocks dates back to 2012, where the first internal research note on Union Pacific began: "*UNP has a strong, defendable moat, an ongoing pricing opportunity, and an inherent cost advantage relative to its substitute, trucking. At the current share price, the risk/reward is in one's favour*".

It's quite remarkable how enduring the core of this investment thesis has proved. In many ways, today, nine years later, the investment case is largely unchanged.

The North American rail industry comprises three duopoly rail networks and one network traversing from Kansas City to Mexico. These assets cannot be replicated, form an important part of the North American supply chain backbone, and have a measure of pricing power that has allowed them to price in excess of their cost inflation over time. Management teams are shareholder-oriented. Over the past few years, there have been several developments in the industry that we think create an opportunity for these to be good investments over the next five years.

Firstly, CSX and Union Pacific, two of the US railroads, embarked on a new system of managing the railroads called Precision Scheduled Railroading, which emphasises moving cars through the network in a scheduled, point-to-point manner as opposed to the old hub-and-spoke model. This improved network throughput, lowered operating costs, increased the network's physical capacity, and improved the responsiveness of the rails, as demonstrated by limited margin compression during the volume downturn in the second quarter of last year. The improved service levels enabled by PSR will help the rails take market share from trucking over time. Historically, trucks have achieved over 90% of deliveries on time compared to 50-60% for rail. The gap has reduced significantly, with CSX claiming to have been on par with trucking in 2019.

Secondly, Covid-19 decimated the economy last year and, as mobility improves, we expect economic growth to pick up. However, as we stand today, inventory levels in the economy are below normal and global supply chains are stuttering. The railroads will be critical to getting inventory levels back to a normal level so that the economy can begin operating more smoothly. This should drive solid volume growth for the rails.

Thirdly, the rails compete with trucks over shorter haul lengths and for certain commodities. Currently, the truck market is facing driver and truck shortages, resulting in high truck prices. This has created an environment for the rails to achieve healthy pricing.

Given the above points, we think the US rails are well-positioned to generate low-double-digit free cash flow per share growth, with an attractive starting valuation. Union Pacific is trading at a free cash flow yield close to that of the market, and we think it is an above-average business with better growth prospects over the next five years and above-average prospects in the case of surprise inflation. Canadian Pacific has, arguably, the best management team in the North American rail industry and is in the process of merging with Kansas City Southern, the Mexican railroad. The combined railroad can offer more efficient single-line service instead of having to interchange, the reliability of which we believe will be highly valued by shippers. Both seemingly have been impacted by concerns related to supply chain issues. In time, the supply chain will untangle, and the rails will be important in supporting this.

At quarter-end, the Fund was positioned with 72% in growth or risk assets comprised of the following:

- 56% effective equity
- 2% in property
- 6% in infrastructure
- 8% in high-yield credit

The remaining 28% of the Fund is invested in either more stable assets or diversifying assets, which we think have a lower correlation to equities:

- 7.5% in commodities
- 2% in inflation-linked bonds
- 7% in absolute return
- 11% in investment-grade fixed income

As highlighted in prior commentaries, we continue to feel the fundamental diversification evident in this portfolio construction, with an intentional tilt towards inflation protection at the expense of nominal government bonds, is both more appropriate and more robust than that of the Fund's benchmark, which includes a 40% weighting to global bonds. In addition, certain sectors of the equity market have suffered price dislocations, leaving us more optimistic about potential prospective returns.

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

Portfolio managers
Neil Padoa, Humaira Surve and Louis Stassen
as at 30 September 2021