

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

Performance and fund positioning

Although markets were volatile, the news headlines frequently grim, and the general economic mood quite wary, the first quarter of 2023 was a good one for most asset classes. The global equity index (MSCI All Country World Index) advanced 7.3% while the global bond index increased by 3.0%, both building on last quarter's gains. The Fund outpaced its benchmark, increasing by 3.6%.

At quarter-end, the portfolio was positioned as follows:

- 45% in investment-grade fixed income instruments
- 14% in inflation-linked assets (including 2.5% in gold)
- 10% in high yield fixed income
- 3% in real assets (listed infrastructure and property)
- 22% in effective equity

The remaining 6% was invested across a range of other assets.

We outlined the meaningful change in fixed income markets, and how the Fund responded, in the prior quarter's commentary (Q4-22). This quarter, the most notable changes in positioning have been a reduction in effective equity exposure, a reduction in gold ETF holdings, and an increase in fixed income holdings.

Over the last year, real asset exposure has also halved from over 6% to 3% of Fund with one of the biggest sales being VINCI, the French concessionaire and construction company. VINCI operates toll roads and airports on behalf of various governments and has benefited from the post-pandemic recovery in travel. We have owned VINCI since 2020 and it has been a contributor to our performance over the period. While we still like VINCI for its highly visible, inflation-linked cash flows, the expected return has reduced as the stock has appreciated. We have therefore reduced the position size in favour of more attractive relative opportunities.

Given the sharp rally in risk assets since the October 2022 trough, the range of macroeconomic risks facing investors, and the fact that implied volatility (a key input in pricing options) was low, we took the opportunity to purchase put protection for the Fund in February 2023. These options provide full downside protection on 6% of the Fund until March 2024 if the S&P 500 Index dips below 3 950. While we are highly cognisant that insurance comes at a cost, we consider the all-in expense of 0.4% (or 40 basis points [bps], equivalent to c.3bps per month until expiry) to be a fair trade-off.

In terms of specific stocks, Meta was a top contributor for the quarter, gaining 76%. This performance was driven by two important factors. Firstly, the Family of Apps, which include Facebook and Instagram, reported strong engagement metrics which are important indicators of Meta's ability to surface ads and generate revenue. Instagram continued to narrow the gap with TikTok, and the core Facebook Blue app proved similarly resilient.

Secondly, management's focus has pivoted towards efficiency across the business, culminating in a near 25% reduction in the workforce. Like many of its peers, Meta recruited heavily during the pandemic years in response to a buoyant external environment for digitally enabled technology businesses, resulting in a bloated cost base and creeping inefficiencies. The reduction in cost and layers of bureaucracy should lead to improved profitability and faster decision making.

One remaining source of debate is the heavy ongoing investment in Reality Labs. With much of the investment targeted at foundational technology innovation in, as yet, commercially unproven AR/VR (augmented reality/virtual reality), the payoff profile remains uncertain.

Despite the sharp rerating, we believe the valuation remains compelling. With little in the Meta share price for Reality Labs, the division provides an element of optionality to the investment case. Excluding the losses from Reality Labs, the core business trades on roughly 12 times 2024 earnings, which should grow at a double-digit rate for the next few years, while cash generation should improve due to a normalising capex cycle (after heavy investment in data centres).

In Fixed Income, late cycle dynamics were evident as volatility in shorter-term interest rates rose despite consistency from the US Federal Reserve Board in backing up its guidance to the need for additional tightening with two 25bps hikes and the promise of more.

Continued resilience in core inflation has proven the sticking point for policymakers – while falling energy and other commodity prices in recent months have taken the edge off headline inflation, buoyant labour markets and elevated services inflation have kept central banks hawkish.

This is particularly true in the eurozone, where the European Central Bank has arguably lagged its peers in raising rates; two additional 50bps hikes in the quarter took the main policy rate to 3.5% in an effort to get ahead of unsettled inflation expectations. Conversely, the UK has turned more circumspect, reducing the pace of rate tightening to 25bps increments and is probably the closest to concluding its tightening cycle of the primary developed market central banks. In Japan, a leadership change at the BoJ (Bank of Japan) has the potential to mark a meaningful shift in policymaking. The BoJ has thus far been an outlier among peers by not tightening monetary conditions. Given the significance of Japanese savers within several key global fixed income markets (including the sovereign debt of the US, France and the Netherlands), significant domestic policy adjustments could have ramifications elsewhere.

Global spread markets were impacted by stress in the banking sector, as a flight of deposits culminated in the failure of Silicon Valley Bank (SVB), prompting fears of a systemic crisis. However, the subsequent strain seen across many other regional US banks contrasted markedly with the banking crisis that preceded the Global Financial Crisis in 2008/09, which was characterised by poor asset quality and the uncertainty around who was exposed to credit losses.

Indeed, despite lingering fears of contagion, there is a growing consensus that the collapse of SVB and forced take-over of Credit Suisse by UBS (the two most prominent events) are outliers, rather than representative of systemic fractures within the US and European banking sectors. In this light, the re-pricing of financials across both markets appears excessive, and presents an opportunity to accumulate exposure to high-quality issuers that have been maligned because of turmoil within the broader sector. Consequently, we have added both subordinated and senior bank debt, in both G-SIBs (Global Systemically Important Banks) and regional leaders.

FINANCIALS' CREDIT SPREADS SPIKED IN MARCH



Source: Bloomberg; ICE BofAML

Outlook

We remain disciplined in our approach, conducting deep fundamental bottom-up research across the capital structure, and responding to opportunities as and when they arise. In the fixed income space, the stress in the banking sector has created opportunities as credit spreads have widened further. In equity markets, despite aggregate market levels not looking particularly attractive, we are still finding certain stocks that offer attractive returns for investors with a long-term time horizon.

Thank you for your support and interest in the Fund.

Portfolio manager

Neil Padoa

as at 31 March 2023