

TRANSCRIPT: EPISODE 78

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Please note that these are unprecedented times and markets can react very quickly to news. The views expressed are at the time of recording and could change.

[INTRODUCTION]

Ryan Lightfoot-Brown (RLB): Hello and welcome to the Investing on the go podcast by FundCalibre. I'm Ryan Lightfoot-Brown and today we're speaking to Laura Bottega, managing director and lead product specialist on the Elite Rated Morgan Stanley Global Brands fund. Laura, thank you very much for your time.

Laura Bottega (LB): Thanks for hosting me.

[INTERVIEW]

[0:21]

RLB: Now, 'don't lose money' is one the mantras of the team that we have, and it's just certainly run true in the most recent market turbulence. The fund's already back in positive territory year to date and is up about 5%, in fact it got back into the black is early 17th of April, just three weeks after the market low. How has performance been so strong?

LB: Yes, that's right. People do know us for our high-quality stock selection, and we're really focused on absolute risk - trying to avoid losing money. And we think a lot by longer term focusing only on those high-quality compounders, it's a great way to achieve that performance and compound wealth. If you think back to the beginning of the year, it started with high expectations, which worried us, and earnings were the highest since 2005, as the multiples. High expectations are dangerous, as you can imagine, as they're easily disappointed. So to explain the performance Global Brands was defensively positioned from our bottom up stock picking, with over 85% of the portfolio in our three high quality sectors: staples, healthcare and IT, and we thought this defensiveness would be needed and we were right.

Staples remain generally defensive and our companies performed in line with the sector. Stocks geared towards hygiene did well. Whereas we trimmed some of our beverage companies, which

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were under pressure because of social distancing and the closing of bars and restaurants. Software and services were robust, where we performed in line with the overall sector and that's our cloud-based subscription businesses, which proved really good in terms of their sticky revenue. IT services were a bit more cyclical than software, but our holdings in the space were pretty well positioned, as companies are really focused on digitizing. And for healthcare, our bias towards consumables - and those are single use medical equipment - has really helped us outperform. Our holdings are skewed towards those as well as to life sciences and diagnostics. So overall Global Brands, the portfolio, did what we expected in the correction of the first quarter and the three quality sectors in the portfolio fell roughly 10% to 13% compared to 21% fall in the MSCI World Index. And they were far more resilient because of it, because their earnings generally are far more resilience.

[2:47]

RLB: Well, I can certainly see how those are healthcare companies would be doing quite well on single use at the moment. With that in mind, has the fund had any new holdings at all, or have you removed any stocks that those ones that you said were a little under pressure?

LB: Yeah, it's important to understand there were no wholesale changes to the portfolio positioning as it was already pretty defensively positioned. What we did want to check is that none of our companies faced any significant balance sheet risk, so that we didn't have to sell any of those for that reason. Where we did reduce positions, it was, as I mentioned, reducing exposure to social-distancing type or stocks challenged by that, such as Pernod Ricard, or Coca-Cola in beverages, but then also adding into hygiene place like Reckitt Benckiser.

We did put two new positions in the first quarter, Proctor and Gamble (P&G) and LVMH, and we sold one staples name Church & Dwight. So, on Proctor and Gamble we recognised already last year that P&G's reorganisation was having a positive effect. It was skewed to top line growth in the US and China, and it was a positive margin story developing, but it was too expensive. So March really gave us an opportunity to get to buy into what we think is a high quality name. It makes a very strong return on capital, and we're now much more confident that it could compound its top line given that focus on the fast-growing markets of China and the US.

Our other new purchase was LVMH. We think LVMH is one of the best luxury goods companies in the world with great long-term growth prospects. And we've owned it in the portfolio before, but sold it because it got too expensive. And again, the price falls in March gave us the chance to get in at a reasonable valuation. LVMH makes a sustainably high return on capital and it should be able to grow its top line you know, under around 5% in the future, powered by of course the very important Chinese consumer. And at the heart of the company is Louis Vuitton one of the biggest and most profitable luxury goods brands in the world, which has helped LVMH compound at around 12% for the last 20 years. So over time it's great management, it's good capital allocation, it's all the things

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we look for typically in Global Brands. And this company has become home to one of the world's most recognised, to a series, of the world's most recognizable luxury brands. And that's a bit more cyclical than the first name I spoke about, P&G, but we think we got in at the right price.

[5:34]

RLB: And now income isn't the mandate of the fund, but one of the investment criteria as part of the process is that each holding must have a little bit of a dividend yield to show that they are committed to existing shareholders. Do dividend decisions like that affect your capital allocation decisions? And with the sort of situation we might have lots of dividend cuts. How do you think the dividend payments of your companies going to hold up in the next sort of 6 to 12 months?

LB: Yes, that's key. Getting capital allocation and governance right is central to our high-quality approach and dividends do play a part. Typically, we prefer dividends over buybacks. We think the discipline of having to pay a regular dividend is important to management, and it matters for the total return to shareholders over the long term. Secondly, we prefer dividends as it doesn't involve taking a view on the company share price. For buybacks to work over time, management have to consistently buy back stock below the long-term value - of the intrinsic value - of the company. For the market overall, we think we're probably looking at two lost years of earnings, 2020 and 2021, and it could be worse than that if there's a second wave of the virus and for the type of companies we own, this has limited impact on long-term value as most of the value's in the terminal multiple, which is pretty unaffected by just two poor years. Importantly, though, we have tested the balance sheets for stress, and we think our companies are resilient and that's the resilience that ties into your question around dividends, as the earnings and balance sheets of our companies are more resilient, they can afford to keep paying the dividend.

So our companies are generally doing much better than other companies in the market, which are over-levered or having to cut dividends as their earnings disappear. Back to governance and capital allocation. If management's over-levered their companies during the good times, they're now being found out and having to cut those dividends. What I would also add is that for investors looking for portfolios with an explicit income mandate and to want to achieve income and capital growth, we do also manage Global Brands Equity Income, that same portfolio of companies as Global Brands but with a derivative over-write and so this portfolio has offered a consistent 4% yield to date.

[7:56]

RLB: One of the things you talked about in the past answer was sort of governance and I know one of the stages in your process is to meet company management. How are you finding this at the moment? Are you doing lots of video calls? And how are the management teams you speak to coping with all these new measures?

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LB: Yes, I think it's a very interesting time and what we're really seeing now is an acceleration and we just put out a piece: 'The Great Acceleration', and that's exactly what you see, whether it is in this smaller context of how you fund managers engage with managers and how do companies respond in an environment where we're not traveling around to see each other. I actually think it speeds things up. As we've seen, there's talk of the last several weeks feeling more like several decades in terms of development in technology. But more than that, we don't have to wait for the next time you see that person - you're able to meet the company and discuss issues immediately, as the information is available. So we're absolutely meeting companies face-to-face Zooms which are all valuable and obviously give you more information than perhaps a conference call, or we're also seeing quite a massive acceleration in virtual conferences at this time, which is, you know group meetings as well.

[9:31]

RLB: Okay and perhaps going a little bit big picture, what's your general outlook for global equities as we stand today?

LB: It's the question of the day isn't it? We're cautious on where, we're pretty cautious on the market outlook. We're facing a recession that's likely to be far worse, than that resulting from the GFC [Global Financial Crisis] and after the sharp move down in March, markets are suddenly now, again, pricing in that complete V-shaped recovery, which we just don't think is likely. We're back to very high expectations and it worries us. Markets seem a little bit more fragile, even in the last days with concerns of a second wave, but expectations still seem too high. And so, for us, it's all about that defensive high-quality portfolio, which is a good hiding place, and it aims, and our Global Brands aims to hold companies with resilient free cash flows and strong balance sheets.

Investment is about risk and reward, threats and opportunities, and the pandemic has acted as an accelerator, especially for e-Commerce and for increased digitization around the world and especially through the cloud. So, the market has been quick to recognise that there are opportunities too in this dangerous time, especially in software. The pandemic I think remains a risk. We've never seen a vaccine being discovered and manufactured in four years, let alone two. And so we think it's far more likely that society will have to live with the virus, whether it's through social distancing or testing programs. And that makes the outlook far more uncertain and volatile than we believe the market is assuming.

Our key message therefore is you have to focus on the resilience. Is the company resilient? Is the team looking after them looking to identify that resilience? And we think we are. Our global equity portfolios have also demonstrated resilience when it mattered. They've done what they expected by delivering reduced downside participation in tough times. So, when you also think about the alternatives available to investors, whether it's value or growth in traditional equity or, or maybe traditional income solutions which have historically been geared to sectors where dividends are now

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scarce, we think quality remains for us the best hiding place. And we think it's especially important when the market's back to dangerously high expectations.

RLB: Well, Laura, that's been really interesting I could talk to you about this all day. Unfortunately, time has caught up with it with us. So, thank you very much for your time. And thank you very much to our listeners for listening. If anyone would like more information on the Elite Rated Morgan Stanley Global Brands fund, please visit FundCalibre.com. And don't forget to subscribe to the Investing on the go podcast for more content from us and all of our Elite Rated funds. Thank you.

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Investment Performance (% net of fees) in GBP

Share Class I ACC	May '19- May '20	May '18- May '19	May '17- May '18	May '16- May '17	May '15- May '16
Global Brands Fund	12.63	18.96	3.53	33.07	10.00
Global Brands Equity Income Fund	9.94	18.28	-0.29	N/A	N/A
MSCI World Net Index	8.88	5.27	8.24	31.26	0.68

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