Ravenscroft

Quarterly Newsletter Q1 2022

COMMENTARY

"Frank Zappa and the Mothers
Were at the best place around
But some stupid with a flare gun
Burned the place to the ground"

Smoke on the Water - *Deep Purple (1973)*

https://cartoonmovement.com/cartoon/meddling-ukraine

by ROBERT TANNAHILL

Eventful is probably an understatement when talking about the first quarter of 2022. Just as we were finally starting to look past the pandemic and hoping that 2022 might mark the return of some normality, we are suddenly dusting off material (and song quotations) on the oil shock in the 1970's and the cold war.

After years of growing regional wars from Chechnya to Georgia to Syria and finally Ukraine; Russia crossed a red line in late February when it moved to force the Zelenskyy government from power. Russia likely hoped for a swift victory that left the West with little to do but wring their hands and accept what had already happened, but this is not what they got. Instead, they have faced fierce Ukrainian resistance and a surprisingly unified West. The unnerving parallels with Hitler's annexation of the Sudetenland in Czechoslovakia in 1938 may have helped convince Western leaders that showing strength early was important.

From an investment perspective this changed some of the things we thought we knew about the future. It caused a surge in commodity prices, notably oil and gas, of which Russia is a major supplier, and hammered home the growing geopolitical divide between the US dominated post second world war global order and rising autocratic regimes, such as China, which want to play by a different set of rules. We will be digesting the impact of these changes for many years to come and asset price changes over the quarter largely reflect markets getting their head around the ramifications of these events. The main impact has been that inflation is not going to be as "transient" as most people thought. Another surge in inputs costs, such as food and energy prices, along with further disruptions to supply chains will keep headline inflation rates higher for longer. China struggling to manage a huge Omicron driven surge in Covid cases, at the same time as rising national security concerns, will undoubtably be a challenge for economies that depend on global supply chains.

It is important to note however, that while we might see some shocking inflation numbers this year (10% is not impossible in the short term), this number is a rate of change and means there are good reasons to expect it to fall back by next year. Although the level it falls back to will likely be above central bank targets of around 2%. This is therefore why markets have moved to price in higher interest rates over the quarter, something we will look at in more detail in the Cautious Commentary.

Over the last 12 months (the Consumer Price Index is generally quoted as a year-on-year percentage change), the oil price has risen from around $60 a barrel to around $100 [1] which means the oil component

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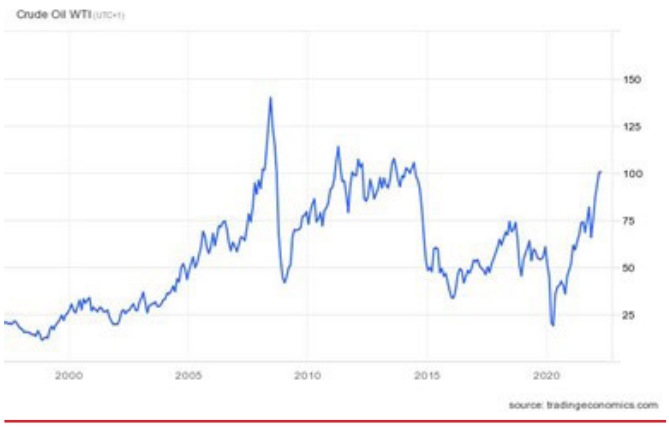
of the CPI figure has risen by 66%! This is part of the reason why core US CPI is running in the 7% to 8% range as I write. To do the same again over the next 12 months would require oil to jump to $166 a barrel which is, historically, unprecedented. There is also a feedback loop here to bear in mind. Higher energy prices act as a brake on the global economy as businesses and consumers cut back on spending to fund higher energy bills. In fact, the last time oil spiked materially over $100 a barrel was back in spring 2008 (as per the chart below) [2] and before the end of the year we had seen a major financial crisis with the collapse of Lehman brothers.



Now, we are not forecasting another financial crisis, the world is quite different to how it was in 2008. It is likely though that some of the key drivers of the current inflation rates from oil or used car prices to US stimulus cheques will subside over 2022. This has left markets and central bankers trying to plan for a higher inflationary environment and the consensus seems to be that the Federal Reserve will hike rates aggressively with a 0.5% bumper hike in May before peaking in the region of 3.25% next summer [3].

Only time will tell if this consensus forecast proves to be correct or not. The good news is that this future is now baked into asset prices. So, for assets like bonds, which have suffered this year, to take further pain, future interest rates hikes need to be even more aggressive than the above scenario. Given that this scenario is already on the aggressive end of history (the Fed only made it to 2.5% in 2018 before the economy started to stall [4]) at a time when the global economy faces major headwinds makes us think that a lot of the interest rate bad news may already be in market prices.

Looking forward, while we believe that markets have gone a long way over the quarter to price in the known risks, we think that markets could remain volatile from here. The pandemic may have precipitated a period of change and to help guide your portfolios through this uncertain time we have adopted what we call navigation portfolios. These are portfolios that are invested where we see sensible asset prices and attractive fundamentals, but which are cautious enough to weather a storm, and are as diversified as we can make them to reflect the heightened uncertainty we face.

One key thing that we believe may have changed is the primary risk to equity markets. Over the last few decades slower growth was the risk, and in a world of falling inflation, it was always met by central bank easing while government policy sat on the side-lines. Looking forward, we could see a new world where inflation volatility (surprises on the high or the low side) becomes a key driver of equity markets and government (fiscal) policy becomes as important as central bank (monetary) responses. This new world requires a different portfolio and that is the focus of much of our work at present.

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PORTFOLIOS

CAUTIOUS PORTFOLIOS: LOWER RISK

by ROBERT TANNAHILL

Objective: The Cautious portfolio's objective is to increase its value by predominantly allocating capital to fixed-income investments. The portfolio can also invest into global blue-chip equities with strong cash-flows and progressive dividend policies. A neutral position would be a 75% bond/25% equity split and the maximum equity-weighting of approximately 35%. The cash generated can be re-invested to provide capital or taken as an income stream.

The bad news for bond-centric strategies such as Cautious is that in moving to take account of a more aggressive set of interest rate rises than was previously expected, bond prices have fallen materially over the quarter. The Bloomberg Global Aggregate Bond Index for example (a broad measure of global bond markets) fell -6.2% in US dollar terms [5]. By some measures it was the worst quarter for bond markets in 40 year or even 6 years. So, against this challenging backdrop, how did the Cautious strategy perform?

The strategy fell -3.9% [6] over the quarter, marginally behind the sector which fell -3.7% [7]. And while clearly, we are never happy to post a negative figure, we are pleased to see the strategy defending your capital during such a tough time for bond markets by falling materially less than general bond markets. We have long argued that cautious investors are better served in the longer term by having an appropriately sized element of equities in their portfolio, even though it may increase short term capital volatility. We believe this because it adds diversification for periods such as this quarter when bonds broadly sell off. We have taken a number of steps over the last few years to increase the portfolio's robustness in the face higher interest and inflation rates, and so it was pleasing to see this work paying off.

The equity side of the portfolio was quite volatile, as is to be expected with such dramatic events unfolding. After the first two months being broadly negative for equity markets, we saw a rally in March as markets started to get a handle on the likely outcome of the Russia-Ukraine conflict. US growth held up and ceasefire talks showed some tentative signs of progress. However, by the end of the quarter, it was a mixed bag.

The loser was our most "growth" focused fund, NinetyOne Quality Global Equity Income (-4.8%) [8], which suffered on the back of rising interest rates, whilst on the other hand, the winners were KBI Global Sustainable Infrastructure (+2.4%) [9] which benefitted from higher energy and food prices, and new entrant, Prusik Asian Equity Income (+4.9% since purchase) [10] which outperformed from the ongoing Covid recovery in most of Asia and the region being relatively isolated from the conflict in Ukraine. We introduced both KBI and Prusik to add diversity and inflation protection to the equity allocation, so it was very pleasing to see them doing well over the quarter as we had hoped.

Source: Getty Images

The bond side of the portfolio was negative across the board. Our core global bond funds were down between -6.0% and -8.2% [11] while our sterling bond funds fell a little less. We have been cutting these core positions over recent years as valuations looked less and less appealing. At the end of August 2019, we had just under half the portfolio (~46%) in these types of core bond funds along with traditional government bonds. Today, this is down to around a third (~33%).

On the other side of this, we have built positions in inflation durable assets such as US Treasury Inflation Protected Securities (TIPS) and short dated corporate bonds. So, we were pleased to see these assets holding up better over the quarter with our top three bond performers all being from these groups: Royal London Short Duration Global High Yield (-1.2%) [12], Schroder Strategic Credit (-2.5%) [13] and iShares USD TIPS ETF (-3.4%) [14].

The one outlier was Pictet Short Term Emerging Corporate Bond Fund which fell -5.6% [15]. This Fund, due to its focus on emerging markets, was our position most directly exposed to the Ukraine crisis with around 6% of the portfolio in bonds from the region at the start of the crisis. While there will likely be some permanent loss associated with the tragic war (estimated at less than 2% of the Fund's value), we have been in close contact with the team and are happy with how they handled the situation, and most importantly, we see the Fund as actually quite attractively priced at present.

From here, as we outlined in the introduction to this letter, we see markets as having priced in a lot of bad news. This means going forward we are happy that the portfolio is in a position to, over time, regain these losses and continue to deliver for you. As with our other portfolios we are focused on the idea of building a strategy that is capable of navigating a period of change. We are doing this through taking opportunities where we see them, maximising diversification and making sure we can weather the inevitable bouts of periodic market volatility such as this.

12 MONTHS ROLLING PERFORMANCE

	31/03/2021 - 31/03/2022	31/03/2020 - 31/03/2021	31/03/2019 - 31/03/2020	31/03/2018 - 31/03/2019	31/03/2017 - 31/03/2018	Annualised Since Inception 31/12/11
Cautious Portfolio	0.7%	12.1%	-1.7%	4.0%	-0.3%	4.7%

Data is based on sterling based model portfolios net of a 0.75% per annual management fee. The models are run in real-time in line with our equivalent client portfolios and provide a fair representation of actual performance achieved by clients in our opinion. The models are maintained internally and are not subject to external auditing. It is important to note that past performance is not a reliable indicator of future results. Source data: Ravenscroft Investment Management Limited and FE fundinfo; collated 08/04/2022.

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BALANCED PORTFOLIOS: MEDIUM RISK

BY DAVID LE CORNU

Objective: The Balanced Portfolio's objective is to provide capital appreciation through a balance of fixed income and global equities. A neutral position is a 50% bond/50% equity split and the maximum equity weighting is 60%. The cash generated can be re-invested to provide capital or taken as an income stream.

This quarter has proven exceptionally challenging. In January, investment markets were asking three key questions: First, were the high rates of inflation we were experiencing embedded or transitional in nature; second, could Central Banks raise interest rates and withdraw liquidity from the financial system to moderate economic growth and inflation without making a policy error; and, third, could the world learn to live with Covid so that global economies could resynchronise? In February, Russia invaded Ukraine and military, financial and information wars became a reality in Europe prompting a huge spike upwards in the cost of energy and many commodities, adding to the inflationary pressures. This also raised questions around the potential for financial contagion from sanctions against Russia; the future of the US dollar; what this means for world order; and, the likelihood of accelerating and deepening the movement towards deglobalisation. Unsurprisingly, investment markets immediately went into panic mode, but have since begun to regain their poise and recovered some of the losses recorded earlier in the quarter.

Exceptional times require exceptional action; consequently, portfolio activity has been higher than usual this quarter. The net result is that cash has drifted upwards to 9% and we have introduced a 5% exposure to gold (at the expense of fixed interest exposure). Equity exposure remains at a similar level to the beginning of the quarter, although there have been some meaningful changes within the allocation.

Whilst we want to put client capital to work, it seems sensible, at least in the short term, to keep a high cash balance since so many questions remain unanswered.

We have increased exposure to high-quality, defensive and dividend-paying equities, introducing Guinness Global Equity Income, Prusik Asian Equity Income and KBI Global Sustainable Infrastructure into the strategy. This is in keeping with our navigation portfolio mantra and should help to dampen volatility during a period of uncertainty.

Additionally, since there is a higher element of near-term cashflow through dividends, these investments should be less sensitive to a high-inflation environment than more growth-focused investments. Further detail on these funds has been included within the monthly factsheets, but please contact us if you would like further explanation.

We have not held gold within the Balanced strategy for over a decade, so clients may understandably be asking why now and is this a short-term tactical allocation or a long-term structural allocation?

The allocation to gold is motivated by the convergence of trends, recent events and the nature of the Balanced strategy. While none of these criteria, individually, would prompt an allocation to the commodity, collectively, they make a strong case for a short-term tactical allocation and, potentially, a longer-term structural allocation.

Trend 1. The increased correlation between fixed interest investments and equities during periods of stress in investment markets. This is well documented and has been a feature of investment markets since the Global Financial Crisis more than a decade ago. The reason is straightforward: gone are the days when you could buy virtually risk-free sterling AAA-rated bonds at par and receive a coupon in excess of 5% per annum. When investment markets are spooked, credit spreads widen just at the point when equity markets sell off, and there isn't enough coupon in the bonds to meaningfully offset the fall in price. Whilst gilts and treasuries won't suffer the same fall in value, the coupon is derisory, so, investors need to diversify away and embrace credit risk in order to generate sensible long-term returns.

Trend 2. Inflation higher for longer. Several long-term deflationary forces that have been in place for decades are at least partly reversing, courtesy of Covid and the present geopolitical backdrop. Whilst we expect inflation to fall to a more palatable level, there is a real risk that we may be left with a structurally higher rate of inflation than we have become used to in recent decades. "Gold Bugs" cite the metal as being a hedge against inflation and, although the correlation between gold and inflation is imperfect, there is some merit in that argument.

Trend 3. Rising interest rates. The returns from fixed interest investments are more volatile in a rising interest rate environment. You can mitigate the impact by shortening duration – which involves accepting a lower return – or you can hold onto your fixed interest investments until maturity and accept higher volatility.

Recent events. We are all trying to understand the implications of the military and economic war that is being fought and the way that the world order is changing around us. Esoteric risk has increased and in times of uncertainty many investors turn to gold. The shiny yellow bricks should provide a partial hedge against some of the esoteric risk we presently face.

The nature of the Balanced strategy. The aim is to deliver capital growth over the medium-to-long term without taking excessive risk. Historically, fixed income investments have enabled us to generate sensible returns and mitigate risk. Whilst they continue to have a place in the Balanced strategy, they are not as effective as they once were, so, we need to consider including other investments, such as gold, that may help to generate returns and mitigate risks.

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Whether gold is a short-term tactical holding or a long-term structural investment will be determined by events. China, India and many other countries will be questioning how much of their financial reserves they want in the US dollar since finding out that when they want their money, it may not be accessible! Approximately 60% of global central bank financial reserves are held in the US dollar and half of cross-border transactions are settled in the currency. Whilst we don't expect the US dollar to be dislodged from its pre-eminent position soon, it seems likely that some foreign exchange reserves will be redirected, with gold the likely beneficiary. Evidence of such flows would see our short-term tactical allocation becoming a long-term structural holding.

Across the quarter, the Balanced strategy fell -4.5% [16], broadly in line with the IA Mixed (20-60%) Sector which fell -3.4% [17].

12 MONTHS ROLLING PERFORMANCE

	31/03/2021 - 31/03/2022	31/03/2020 - 31/03/2021	31/03/2019 - 31/03/2020	31/03/2018 - 31/03/2019	31/03/2017 - 31/03/2018	Annualised Since Inception 31/12/11
Balanced Portfolio	0.4%	16.2%	-3.4%	7.4%	3.3%	7.9%

Data is based on sterling based model portfolios net of a 0.75% per annual management fee. The models are run in real-time in line with our equivalent client portfolios and provide a fair representation of actual performance achieved by clients in our opinion. The models are maintained internally and are not subject to external auditing. It is important to note that past performance is not a reliable indicator of future results. Source data: Ravenscroft Investment Management Limited and FE fundinfo; collated 08/04/2022.

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GROWTH PORTFOLIOS: HIGHER RISK

by SAMANTHA DOVEY

Objective: The Growth Portfolio's objective is to provide long-term capital appreciation by investing predominantly into global equities. A neutral position is a 25% bond/75% equity split and the maximum equity weighting is approximately 85%.

When our children's children are learning about past events in 30 years' time, the last 3 years will be an interesting study. 2020/21 was all about the Covid pandemic; thus far, 2022 has been about the Russia-Ukraine war and the impact of inflation around the world.

The start of this year has been anything but straightforward. I have been investing in financial markets for over 20 years and the amount of uncertainty we have seen of late reminds me of 2008 (albeit without the big negative numbers – so far).

For those who were not investing back then, you will no doubt be aware of the Global Financial Crisis of 2008/09. From mid-May 2008 to the start of March 2009, the MSCI World Index fell -37.1% [18] and in 2020 we saw the same index fall -25.6% (from 20th February to 23rd March) [19]. In response to the latest geopolitical events, however, investors may be surprised to learn the resilience of equity markets; across the quarter, the lowest point we saw was a fall of -10.9% on the 7 March [20].

Fixed income, on the other hand, (and as described by Bob, above) was extremely difficult across the quarter. We made changes to the Growth strategy's fixed income allocation in response to the markets we were navigating. The exposure is 15% and, historically, has always been "credit" focused. Given heightened inflation numbers and concerns over the escalation in the Russian-Ukraine crisis, the decision was taken to reduce credit and invest in more defensive fixed income with the exposure now standing at: 5% allocation to credit; 4% in US inflation-linked Treasuries; and, 4% in 7-10 year Treasuries (with approximately 2% in cash).

Fortunately, equity markets didn't fall as far as we had anticipated given the combination of factors at play. Markets can be funny things and tend to look past shorter-term events. The short term is the war in Ukraine, but whether the current inflation conundrum is transitory (coming from a low base and heightened energy prices) or more structural in nature is still up for debate.

Structural (i.e. long-term) is more of an issue since this will really hit us in the pocket. Heightened energy and food prices will eventually turn into wage increases – and the impact on companies' profitability will be longer (and returns concomitantly lower).

In his latest AGM, Terry Smith, CEO of Fundsmith, addressed the inflation question and stated that owning quality businesses – those companies that exhibit high gross margins and other quality metrics – can protect against inflation. This is all to do with having lower input costs, which heightens gross profit, which then protects your bottom line. As you know, our investment thesis centres around capturing exposure to companies with this quality bias, so we believe we should be able to protect on the downside should inflation become more structural in nature.

Equity markets started to roll over towards the end of last year (around 8th December). This was before anything started in Eastern Europe and was driven by rising inflation concerns. I have explained elsewhere that increased inflation tends to lead to higher interest rates and that these higher rates must then be used to discount a company's future cash flows. As a result, when trying to ascertain the value of a company or its future share price, this can lead to dramatic falls in previously highly valued enterprises.

The inflation issue we saw emerge in 2021 has not gone away, it just happened to be commodity related (here I mean both energy and food prices, rather than the maths of re-rating from a low base). Currently, the equity allocation in the strategy stands at 78%. In some instances, we saw some of our equity funds fall far more heavily than we expected. From 8th December 2021 to 31st January 2022, these were Fundsmith Global Equity (-8.6%) [21], GuardCap Global Equity (-6.9%) [22] and Polar Capital Global Technology (-14.6%) [23], versus the MSCI World Index which only fell -5.6% [24] over the same period.

It was at this point that we decided to add to our holdings: both Fundsmith and GuardCap received 1% top-ups, taking the allocations to 10% each; and Polar Capital Global Technology received 0.5%, to take the fund up to 5%.

While this may feel uncomfortable, Warren Buffet would say to "Be Fearful When Others Are Greedy and Greedy When Others Are Fearful". Put another way, if you liked the coat at £100, then you absolutely love it when it goes on sale for £50 – it still does the job you wanted it to do!

There are a few questions we go through when adding to fund managers in a falling market, which are as follows:

- Is the investment thesis still robust? In this instance, do we think the quality companies held in the portfolios will continue to exist in years to come? If the answer is yes, then that is one hurdle that has been jumped.
- Secondly, make sure you communicate with the fund managers; they speak to the underlying companies and know first-hand what is going on. If they are happy, then that should alleviate any "fear" you may be experiencing – another hurdle overcome.
- Ultimately, have you managed to buy your coat for half the price? If so, you are winning. A final hurdle cleared.

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In summary, whilst we may not always get the timing perfect, being fully invested at the bottom is helpful when markets turn. The key question we are asking ourselves is whether markets have turned or if we will experience a further downward trajectory from here. The honest answer is that we do not know, but I am happy that I bought my coat for £50. We may well get the chance to buy another coat – or indeed some shoes, too. Regardless, we will be keeping our eyes on the sale rail should any interesting opportunities come along.

12 MONTHS ROLLING PERFORMANCE

	31/03/2021 - 31/03/2022	31/03/2020 - 31/03/2021	31/03/2019 - 31/03/2020	31/03/2018 - 31/03/2019	31/03/2017 - 31/03/2018	Annualised Since Inception 31/12/11
Growth Portfolio	3.4%	26.0%	-7.7%	7.7%	3.3%	9.2%

Data is based on sterling based model portfolios net of a 0.75% per annual management fee. The models are run in real-time in line with our equivalent client portfolios and provide a fair representation of actual performance achieved by clients in our opinion. The models are maintained internally and are not subject to external auditing. It is important to note that past performance is not a reliable indicator of future results. Source data: Ravenscroft Investment Management Limited and FE fundinfo; collated 08/04/2022.

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GLOBAL BLUE CHIP PORTFOLIOS: HIGHER RISK

by BEN BYROM

Objective: The Global Blue Chip portfolio invests into approximately 25-30 global blue chips that are in line with our long-term investment themes. The aim is to invest into such companies at an attractive valuation and hold them for the long term. The cash generated can be reinvested to provide capital growth or taken as an income stream.

Well, that's that, Q1 done and dusted – and just like that, we have transitioned, as if walking through the wardrobe to Narnia, into a world that takes some believing...

- **Quantitative tightening has arrived.** Central Bankers are tightening easy monetary policies in a bid to keep inflation contained. Subsequent rising interest rates are forcing investors to revaluate their 'buy the dip' capital allocation strategy.
- **There's now a war in Europe.** Russia invades Ukraine, unleashing a never-seen-before series of economic sanctions and asset seizures. Recent revelations make for grim reading and it's almost incomprehensible that genocide is once again happening on European soil.
- **Energy crisis.** The war in Europe is exacerbating the energy crisis and raising the price of agricultural commodities adding inflationary pressure to a financial system that is still reeling from Covid-induced supply chain disorder.
- **Talk of recession gets louder.** Rising prices will impact consumer spending habits and company margins. After 10 years of growth an economic recession cannot be ruled out.

Despite this backdrop, and more understandably how we all feel about the situation, the MSCI World Equity Index was down just 2.4% [25] for the quarter – the divergence in sector performances can be seen in the black bars in the sector performance chart (below, middle).

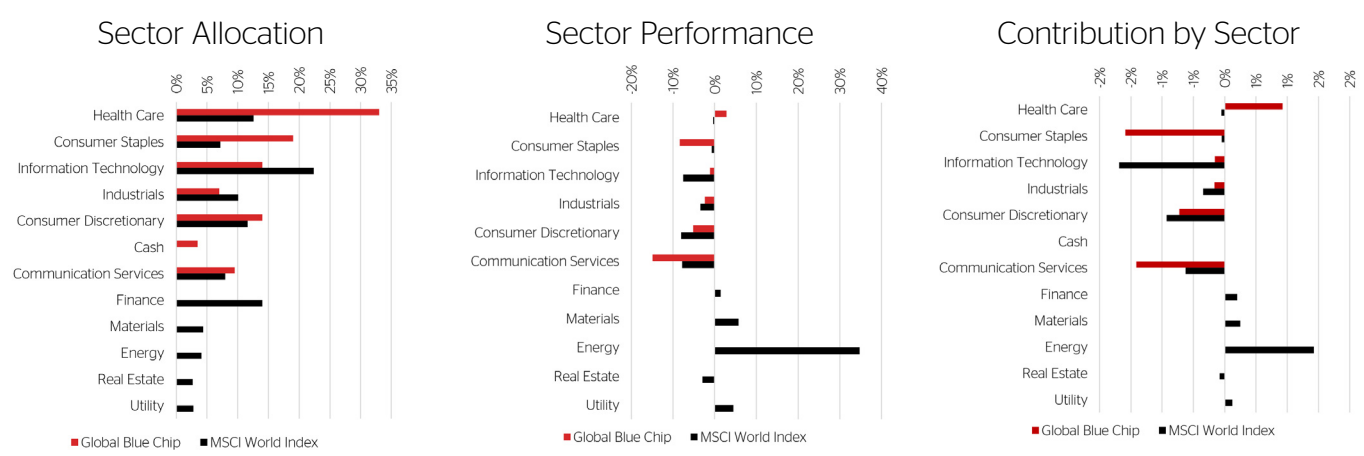
The Global Blue Chip strategy navigated this period of uncertainty relatively well with a decline of just 3.7% [26]. What worked and what didn't, can be seen in the Contribution by Sector chart (below, right) which is the product of our positioning to each sector (below, left) and the collective performance of our holdings (below, middle). For comparison purposes we map our data against that of the MSCI World.

You can see that the negative contribution by our staple and communication positions, as well as not having a presence in energy companies, delivered the biggest blow to performance in relative terms. This underperformance was partially offset by the strength in healthcare and our outperformance in technology, industrials and consumer discretionary.

The energy sector was the star performer for the quarter as the price of oil surged towards $130 a barrel during the early stages of the war. However, to many, it was just a matter of when we reached these prices rather than if: the too-low-for-too-long pricing that took centre stage over the past 8 years has led to drastic underinvestment in developing new reserves. The war in Ukraine simply exacerbated a tight supply/demand situation that has the potential to dramatically rebalance geopolitical alliances.

You should be forgiven for thinking that consumer staple companies and their branding prowess would have the necessary pricing power to help offset the impact of rising in-put costs. These businesses mass produce every-day, must-have items, and should theoretically be able to offset higher input costs with small, hardly noticeable, price increases on each unit produced. The money poured into marketing would cement our emotional ties to their brands ensuring we are more willing to suck-up the costs. That's the theory, anyway. Yet the sector has been weighed down by rising input costs due to soaring raw material prices and supply chain disruptions lasting well over a year now.

The impact of such exogenous shocks is immediate on a business, but the ability to react with price increases can lag for a variety of reasons. Two reasons, that are not mutually exclusive, include management uncertainty about the future direction of pricing and competitive pressures – how bad are other competitors suffering and who is going to raise prices first and potentially cede market share? Those that have been brave enough to hike prices so far have had mixed results. Some have benefitted from "innovation" as consumers believe they are paying-



Source: FactSet and Ravenscroft Investment Management Limited

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up for a better product whilst others have seen volumes fall – suggesting consumers have traded down and may not be as 'connected' to the brand as one would have liked. We wait to hear how the ongoing pricing pressure continues to impact our staple holdings and whether they have the brand power (or product quality) to keep consumers engaged at elevated prices. With more consumer staple companies having no option but to follow suit, we'll see if consumers return, or whether some of our businesses, such as Unilever or Henkel, have a bigger problem. That said, those companies are now trading on very compelling valuations and are now priced for no growth in our opinion and the main reason why we continue to hold them.

The rout has been worst – since it has been going on the longest – within technology related stocks, where the deathly combination of rising rates (which reduces the present value of future returns) and a collapse in multiples from elevated levels has resulted in devastating capitulations in value. This meant we were able to pivot into businesses that we had been watching for some time but couldn't justify owning from a valuation perspective. Market volatility throughout the quarter offered us attractive entry points into Amazon, Etsy, PayPal and an opportunity to add to our holding in Netflix. We continued to build positions in companies that will enable us to benefit from the ongoing trend in online commerce, payments, and entertainment.

If only we could stumble back through our wardrobe to a place much more familiar and safer – where time stood still awaiting our return. Unfortunately, we have no option but to deal with the here and now. Our investment process will be our guiding light: understanding what we own, why we want to own it and the price at which we are prepared to transact. The current macroeconomic and geopolitical situation isn't helpful, but we do adopt a 'through cycle' approach that aims to normalise the rate for the time period at hand and we add a bit extra to ensure we are compensated for some of those unknown, unknowns. Afterall, all things being equal, it will be price that will be the main determinant in the future return one should expect to earn from any prospective investment. Put simply: buy low, sell high, know why.
We see our role, irrespective of the environment, to invest in compelling opportunities when they materialise and sell them when the future returns do not justify the inherent risks. We believe this process has the ability to drive sustainable returns for our investors in the years that follow. In the interim, times may get tough but it is during these times that the best investment opportunities present themselves. An example of our process is illustrated by the Stock in Focus, which describes one opportunity we recently took advantage of: PayPal.

12 MONTHS ROLLING PERFORMANCE

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Global Blue Chip Portfolio	8.9%	23.2%	3.1%	20.2%	-5.1%	11.9%

Data is based on sterling based model portfolios net of a 0.75% per annual management fee. The models are run in real-time in line with our equivalent client portfolios and provide a fair representation of actual performance achieved by clients in our opinion. The models are maintained internally and are not subject to external auditing. It is important to note that past performance is not a reliable indicator of future results. Source data: Ravenscroft Investment Management Limited and FE fundinfo; collated 08/04/2022.

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Strategy is currently not available to UK investors

GLOBAL SOLUTIONS: HIGHER RISK

by SHANNON LANCASTER

Objective: To generate capital growth over the long term (over 5-10 years). The strategy invests into 10-20 carefully selected third party equity funds; following the same, stringent investment process as the other multi-manager portfolios in our range. It is a highly focused portfolio which invests in companies providing goods and services dedicated to finding solutions to the challenges the world faces today.

As the first three months of 2022 end, we are reflecting on a particularly volatile start to the year. With global economies feeling the strain of Covid's impact on supply chains and the shift in consumer spending, Russia's invasion of Ukraine at the end of February just added fuel to the inflation fire. Commodity prices and rates accelerated higher from existing uptrends as the West imposed strict sanctions on Russia's economy and central bank.

Amidst the chaos, we launched our first new strategy in eight years, Global Solutions. While we closely monitor our underlying funds, we also keep an eye on how our themes are developing. Changing demographics, accelerating innovation and the rise of the emerging class are key themes we currently have exposure to in our strategies. Over time, the investible opportunities within themes have evolved and we have found some very attractive funds in more niche areas. What started as a handful of environmental solution names, developed into a variety of funds investing in areas like oncology, nutrition and decarbonisation and it became clear that there were more than enough of these highly thematic funds to sit in a standalone portfolio.

Some of the most critical challenges we face today are related to people and planet. We believe that companies which help to solve the world's chronic challenges should experience growth over the coming years. The themes we invest in explore solutions in these areas: environmental solutions, basic needs, energy transition, emerging equality, and resource scarcity.

Environmental Solutions

Climate change is one of the biggest challenges of our time. Increased awareness of climate issues by regulators, investors and governments provides a tailwind for investing in this theme. We are seeing more disruptive investment opportunities coming to market every day in this space. We are at the inflection point of change as innovative technologies will disrupt a wide range of businesses.

Basic Needs - Nutrition, Healthcare, Water and Waste

We believe everyone should have access to clean water, waste management, healthcare and nutrition. Water, waste, healthcare and nutrition are areas that are all interlinked. As populations grow and become more urbanised, we need more access to clean water and efficient waste management systems. In addition to this, climate change will increasingly put pressure on food production and access, especially in vulnerable regions, undermining food security and nutrition.

The world is getting older and with age unfortunately comes the increased risk of ill health. Our healthcare exposure is to businesses aiming to make the system more accessible and efficient. It also includes cutting edge innovative companies working on the research, diagnosis and treatment of various illnesses.

Emerging Equality

The basic needs we have discussed previously are global issues. This theme focuses on basic needs in the emerging world as it also takes into consideration the unique challenges these regions may face. For example, emerging markets regions are experiencing increased urbanisation which will require more materials, energy, water and waste management solutions. However, many of these regions are quite vulnerable to the impact of climate change. Investment is needed in domestic solutions providers that can find a balance between socio-economic progress and climate issues.

Energy Transition

The energy sector is due to undergo a huge transformation over the next few decades at an unprecedented rate. Coal, oil and gas are all finite resources and while renewable energy is well on its way to becoming a core part of our energy mix, there is still a long way to go. Clean energy sources are increasingly being used as cost effective and low emission alternatives to traditional energy but renewable energy use needs to rise substantially if we are to meet climate targets.

Investing in the energy transition is not only about generating power from renewables. Mass introduction of electric transport infrastructure, energy storage, improved transmission and distribution networks, coupled with the increased usage of technologies to improve energy efficiency, are all part of the transition too. We expect this to prove hugely disruptive to the energy industry over the next few decades.

Resource Scarcity

As the world becomes more populous, urbanised, and prosperous, demand for energy, food and water will rise. The earth has a finite amount of natural resources that can be used to satisfy this demand. We need to balance efficient use of these resources with demands of global growth. The funds in this theme invest in businesses providing products and services that held us do more with less and the innovative businesses creating new materials to meet our needs.

The Global Solutions portfolio aims to benefit from the powerful trends shaping the world around us by investing across a diverse range of funds that give investors exposure to a variety of businesses from today's well-established companies to the success stories of tomorrow. There are multiple tailwinds that we believe will benefit the areas we invest in and that the portfolio could benefit as these themes unfold over the coming decades.

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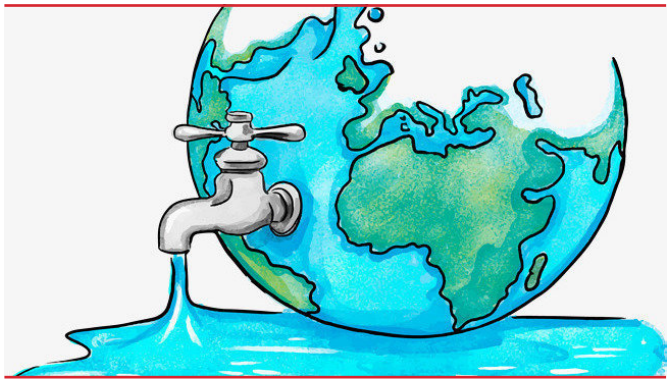
FUND IN FOCUS:
Why Waste & Water?
by SHANNON LANCASTER

With the launch of our new strategy, we were spoilt for choice when it came to writing a Fund in Focus on this quarter. We have selected Regnan Waste & Water as it sits within both our Growth and Global Solutions portfolios.

As the global population grows, the world must improve its management of water resources and physical waste if it is to grow sustainably and enable future generations to meet their own needs.

Life on earth is dependent on water. It is not only essential for the production of food but is also extensively used in all forms of economic activity including industrial manufacturing, semiconductors production and materials extraction. In addition, the water necessary for cleaning, cooking and washing typically amounts to around two hundred litres a day. Yet our water footprint can sometimes reach ten thousand litres a day. Water is often seen as a free resource due to its necessity for life, but access to safe and clean water is not. The price we pay for water is the price of cleaning and transporting it to our point of use. This price therefore varies greatly depending on where you are in the world, the state of the infrastructure, its age and efficiency.



Another key issue we face is regarding waste management. Growing global consumption means growing waste and managing this is one of the key issues facing the world. The world generates 2 billion tonnes of solid waste annually and this figure will increase.

So how do we access the water and waste management theme?

We invest in Regnan Waste & Water Fund which invests in companies that provide solutions to global water and waste related challenges. The team at Regnan are pioneers in combining exposure to both water and waste businesses. The Fund invests across the water and waste value chain including those incumbent firms in the industry and those producing the new technologies to address these challenges. There's no economy without water and no sustainable economy without waste management. This presents a dual opportunity for the portfolio to have both defensive and growth like characteristics.

The team believe there are a number of key drivers in place that will make investment in these areas attractive. Firstly, they believe urbanisation trends will continue and population will become more concentrated. They believe this population will continue to consume and be more water and waste intensive. In addition they believe infrastructure investment will be needed across the world as our water footprint grows. Infrastructure pressure is being driven by ageing infrastructure in the developed world and by new projects in emerging markets, this follows network repairs and new build as well as investment in waste solutions. In addition to this, there is a supportive regulatory environment with more focus on regulation and health.

The fund acts as a great diversification tool in our portfolios providing exposure to different businesses, sectors and regions. It has more exposure to industrials and utilities and has less technology than some thematic funds. They invest across the market cap spectrum which means the fund behaves differently to our other holdings.

We believe the unique combination of investing in water and waste together provides access to two complimentary sectors which benefit from secular growth trends. Investments made across the two value chains vastly increases the investment universe. Despite the human need for both water and waste management, they are still hugely under-researched sectors globally. We believe the team at Regnan are best placed to take advantage of this through the Waste and Water Fund.

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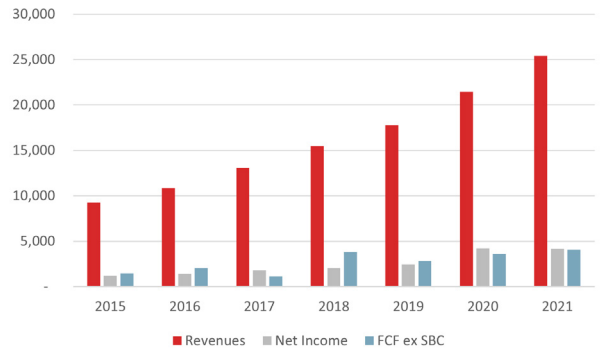
STOCK IN FOCUS:
PayPal
by SAMUEL CORBET

As Ben highlighted in the quarterly review, the first quarter proved to be an active time for the Global Blue Chip strategy with three new additions to the fund: PayPal, Etsy and Amazon. These replaced our positions in 3M and eBay, which we exited from the portfolio. All three companies seek to benefit from the tailwinds provided by the continued transition to e-commerce (which today still accounts for less than 20% of total commerce) and the digitalisation of the economy, more broadly. These are businesses we have been following and admired for a long time, but whose share prices we deemed too expensive to warrant investment. The recent bout of volatility provided us with the opportunity to initiate positions in these high-quality businesses at prices we believe to be attractive for long-term holders. Below, we take a closer look at PayPal.

For anyone unfamiliar with PayPal, the company operates a two-sided payments network that is used by over 426 million consumers and 34 million merchants to facilitate transactions between its members [27].

The Company can trace its beginnings back to Peter Thiel and Max Levchin who founded a company called Cofinity in December 1998. The PalmPilot was the dominant handheld computer at the time and Cofinity initially developed software that enabled users to send money to each other by the infrared port on their devices. From here they pivoted to payments via email and this became the basis for what emerged as the PayPal you see today. Around the same time, Cofinity merged with Elon Musk's x.com and he went on to become the chairman and CEO until he was unceremoniously ousted in late 2000. The company went public in early 2002 and was subsequently acquired by eBay later that year, where it remained until 2015 when it was spun out as a separate company. PayPal's rise is symbiotic with that of the internet as people sought to find ways to transact, securely, online.

If we look at the performance over the past five years since the company became public (for the second time) PayPal has compounded its revenues at an annualised rate of 18.5%, earnings per share has grown at 25% and free cash flow (adjusted for stock base compensation) has grown at 14.6% [28]. The free cash flow growth rate is lower partially due to the uplift provided by the unrealised gain on investments (which is included in net income, but excluded when determining free cash flow) and also due to the relative increase in stock-based compensation, which today represents almost 22% of the total cash flow from operations (up from 13.6% in 2015). Irrespective of this, the company is highly cash generative and has been able to invest a significant portion of this back into the business and achieve high returns for shareholders – which is typically the type of business the Global Blue Chip strategy favours.



Source: FactSet and Ravenscroft Investment Management Limited

In 2021, management held an investor day where they laid out their plans for the next five-year period. The strategic priorities can essentially be boiled down to two factors: digitalisation of the offline economy and increasing engagement levels of its userbase.

PayPal estimates that the addressable market opportunity within its top 7 markets, in 2025, will reach $2 trillion. By comparison, the offline commerce market in these same regions represents an $8 trillion opportunity. Clearly this is a significant opportunity for PayPal and a potential game-changer for physical retailers who will be able to offer their customers access to the same payment options that PayPal's online merchants benefit from (including the ability to pay for transactions with cryptocurrencies and access to interest-free Buy Now, Pay Later credit).

At the same time, the company is aggressively expanding the services it offers beyond payments with the goal of increasing levels of engagement among its users. The illustration below is taken from the Investor Day slides and depicts the company as a growing city. The top illustration shows the facets of PayPal's business today relative to how management believe the business will look in the future (below).

Source: https://s1.q4cdn.com/633035571/files/doc_events/investor-day/2021/PP-Investor-Day-2021-Combined-FINAL.pdf

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Increasing the number of services offered increases the opportunity for interactions with its users and management knows that users who are highly engaged generate at least 2x more revenue than the average user. Longer-term, management aspires to reach 1 billion daily active accounts – a goal that, if achieved, provides plenty of scope for future growth and would see a 19x increase in current interactions.

Part of prudent management is being cognisant of the risks that could arise which would derail our investment case. Historically, PayPal's meteoric rise was propelled by the fact that it was unquestionably the most convenient (and safest) checkout method available – when the alternative was physically posting a cheque to a merchant, the bar PayPal's innovators had to overcome had been set pretty low! As the industry plays catch-up, in order to remain relevant in a digital-first world, the incremental value PayPal provides over alternatives payment methods diminishes.

Our preference is to invest in businesses whose products/services are so clearly superior that it is a no-brainer for the end-user to adopt. We believe this is the case with the solutions PayPal provides today but (in an increasingly competitive industry) it will be important to regularly reassess these services to ensure PayPal's retains its appeal (centred around trust and convenience).

As discussed above, PayPal has been extending the range of services it offers in order to increase engagement levels with its users. Recent examples included the acquisition and integration of Honey (a voucher platform that provides consumers with discount codes and automatically applies them at checkout) and the expansion of its consumer credit services to include a Buy Now, Pay Later option which (unlike competitor products) it offers its merchant at no additional cost.

As long-term investors, we like management teams that obsess over exceeding the expectation of their customers in the knowledge that profits will inevitably follow. There is little doubt that PayPal's consumers love the ability to pay for their goods over an extended timeframe and, clearly, merchants enjoy the incremental sales this brings, especially since they assume zero credit-risk and there is no additional fee associated with these transactions.

However, it would be remiss not to acknowledge the fact that this particular innovation does change the risk profile of the business and sees PayPal transition from a rent collector, on the transactions processed across its network, to a provider of unsecured lending. We will be paying close attention to ensure PayPal is not pursing an unacceptable level of risk as part of this strategy to increase engagement levels.

This is clearly an exciting time for the company and an opportunity for it to significantly expand its reach beyond simply facilitating online payments. However, such transformation gives rise to execution risk and the range of potential outcomes naturally increases as a result. We recently wrote an article which explained our preference for businesses with a high degree of free cash flow predictability (which can be accessed on our website here) In this, we discussed our approach when faced with an opportunity to invest in a high-quality business, albeit where the range of outcomes is wider. In such instances, we concluded that we would require an additional margin of safety in order to compensate us for the additional risk assumed. As such, we would only look to increase our PayPal allocation further, if:

1) We were able to do so at a price that discounts the execution risk.
2) Management continues (as it has done, historically) to execute well and the risk of pursuing this expanded strategy diminishes over time.

We look forward to continuing to watch the business evolve over the coming quarters and updating you with the developments.

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BOSCHER'S (BITE-SIZED) BIG PICTURE: A RAPIDLY CHANGING GLOBAL ECONOMIC, GEO-POLITICAL AND MARKET ENVIRONMENT

by KEVIN BOSCHER

A month into the Ukraine war, we are all deeply shocked, saddened and angered by the tragic events in Ukraine and hopefully, we will see a peaceful resolution to this conflict in the very near future. Not forgetting the human sympathy and moral indignation, it is important to consider the implications of the war for the global economy and financial markets.

This crisis has erupted at a time when the macro environment was already in transition and facing a challenging backdrop. The world economy is still exiting from the Covid pandemic and growth was already slowing due to the removal of the extreme monetary and fiscal stimulus whilst inflationary pressures are at a generational high. To make matters worse, the temporary supply and demand disruptions and labour shortages created by Covid are persisting much longer than anticipated and are starting to impact longer-term pricing behaviour and wage expectations. At the same time, the long-term transformation in energy and transport systems, largely due to environmental considerations, is adding to the pressure on global commodity and energy resources. This is a tough time for investors and policy-makers to make decisions because the contours of the global economy and geopolitics are changing rapidly, and it seems like everything is tilting towards the negative side. Political tensions were already running high, but the threat of a new "cold war" has only added to the anxiety.

Some investors are comparing the current economic climate with the oil crises in 1973 and 1979. Back then, the combination of the Yom Kippur War, which triggered the first Arab oil embargo, and the Iranian revolution led to a near five-fold increase in oil prices, a doubling of US inflation to around 14%, a Fed Funds rate of 11% and a prolonged bear-market in US equites, which fell 53% in real terms. Whilst the world economy and especially the US has much in common with this period, there are some important differences as well. A key contributory factor to the inflation spike was a significant devaluation of the Dollar as the US left the Gold Standard. For the past year or so, the Dollar has been appreciating on a trade-weighted basis. In addition, the US and other major economies are less energy-intensive than 50 years ago and political conditions are less favourable to unions and organised labour. Also, technology arguably plays a bigger role in today's world and labour shortages and wage pressures will spur a longer-term boost in labour-saving technology investment, which should improve productivity trends. History never repeats but it rhymes and whilst there are structural differences in price, energy and wage dynamics between then and now, the risks cannot be ignored.

The most important factor that will likely determine the investment outlook is the future direction of inflation, bond yields and interest rates. Significant increases in the cost of money matter a lot for an economy since they raise the discount rate to be applied to companies' future cash flows and hence, tend to reduce their value. Also, they make mortgages more costly, threaten the store of wealth represented by housing and other financial assets and make it more expensive for companies to borrow, repay or refinance their debts. Since the early 1980's, bond yields and interest rates have been trending lower with each successive financial or economic crisis forcing central banks to cut rates further and, eventually, to embark on Quantitative Easing. This long-term trend has been due to several powerful secular forces putting downward pressure on growth and inflation, including an ageing demographic, shrinking workforce, globalisation, an abundance of savings and technological disruption. Falling bond yields and financing costs have boosted demand for and the valuation of financial assets and stimulated corporate profitability.

Just a few weeks ago, central banks were grappling with the considerable challenge of maintaining post-pandemic recoveries in the face of surging inflation. Now, the Ukraine crisis has made that policy dilemma even more acute since it will push inflation even higher whilst substantially raising the downside risks to economic activity. Although Russia is a relatively small economy, the impact of sanctions, a growing number of companies pulling back from doing business in the country, higher energy costs, a possible Russian debt default, falling financial markets and greater uncertainty will weigh heavily on economic activity. Prior to the invasion of Ukraine, there were promising signs that some of the supply disruption and labour shortage pressures were easing; but the war, together with further Covid lockdowns in China, is threatening this improving picture. Surging commodity prices will wreak havoc on the global manufacturing sector, aggravating Covid-related supply disruptions and compounding existing inflationary pressures. Central banks, and the Fed in particular, are in a tough spot. The key message emanating from recent meetings is that they seem more concerned about the inflation threat and are poised to press ahead with their planned policy tightening.

Central banks would do well to remember the dominant secular forces at play and the fact that the global economy is very sensitive to higher financing costs given the high and rising levels of debt. At the same time, governments are already committing to spending more on energy security and defence in addition to the need to address an underinvestment in healthcare, income and wealth inequality and climate change. This will add to the central banks' problem as the increased

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spending and bigger fiscal deficits will need to be financed at relatively low cost. Since the late-1970s, there have been 16 cycles of monetary policy tightening in the US and Europe, 13 of which have ended in recession. Soft landings are hard to achieve and the macro backdrop is extremely challenging. The Fed and other central banks will likely push ahead with rate rises over the next few months. However, we think they will eventually be forced to become more dovish and we expect rates to peak considerably lower than current expectations. Ultimately, higher energy costs are inflationary short-term, but disinflationary longer-term. We remain unconvinced that the cyclical surge in inflation will develop into a longer-term problem, although we are less certain than before the Ukraine invasion.

From an investment perspective, equities have recently recovered some of their losses despite the war, but remain in negative territory year-to-date, in some cases substantially so. Expensive growth stocks (including Technology) have struggled due to rising bond yields whilst commodity-related equities have outperformed. This rally in stocks likely reflects a bounce from excessively pessimistic sentiment and positioning, share buy-back activity and quarter-end related re-balancing of portfolios towards equities. Markets will probably stay volatile for some time, not just because of Ukraine but also because of the challenging macro backdrop and uncertainty over interest rates and inflation. The risks for equites and credit markets appear to be skewed to the downside in the near term given the rapidly changing and hugely uncertain backdrop. In addition, the economic fallout from the Ukraine crisis is yet to be felt, but the collateral damage from the conflict and ensuing sanctions will prove costly and recession risks are growing, especially in Europe. Having said that, markets have already fallen materially in some areas and have probably discounted much of the bad news.

We have made a number of changes to our portfolios recently as we seek to be more defensively positioned whilst looking to invest in some of the areas which are likely to benefit from the crisis. This includes commodity and energy-related plays as well as quality stocks aligned to our long-term themes, which have become more attractive from a valuation perspective. In our view, it is too early to increase exposure to risk assets, but we will be looking for opportunities to do so over the coming weeks and months. There are a number of catalysts that would lead us to become more bullish and increase exposure to equities, in particular. These include an end to the Ukraine crisis and lower energy prices, a signal that the Fed is stepping back from its hawkish bias, significant fiscal or monetary easing from China and signs that inflationary pressures are easing. The post-pandemic world is changing in so many ways that successful investment strategies will need to evolve in sympathy. But we are optimistic that we can continue to deliver attractive returns for our clients over the next few years from an active, flexible and diversified approach.

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Data Sources

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All performance data above was collated on 08/04/2022.

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