CREDO 20 YEARS

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Are there any lessons we can apply to help establish an approach to best achieve our future financial objectives?

Time in the market

At the time of writing this article, we have just experienced a very turbulent October, with most of the world equity markets all suffering heavy falls. The S&P 500 had its worst month on record since September 2011, ending approximately 7% down.

It is perhaps appropriate, or at the very least instructive, in this, our last newsletter in our 20th anniversary year, that we reflect on the performance of the S&P 500 index over the past couple of decades. What can we learn from the S&P 500 performance over these past 20 years? Are there any lessons we can apply to help establish an approach to best achieve our future financial objectives?

At this stage I will caveat what follows by stating that each person's financial requirements are undoubtedly different, hence in my view this learning is best applied to all those investors who are able to take a long-term view, which after all is what investing should be all about.

One should not be *"driving whilst looking only in the rear-view mirror"*, but rather concentrating on the windscreen to see what lies ahead.

This is a good analogy as to how investment decisions are best made, however it remains interesting to examine past performance, albeit we have the age-old investor warning, *"that past performance is not an indicator of future performance"*.

The level of the S&P 500 on 1 November 1998 was 1,144.43, and 20 years later, on 2 November 2018 it had grown to 2,720.46, a multiple of 2.38 times, or an increase of 138%, which translates to a 20-year compounded IRR of circa 4.5%.

These figures include both the technology bubble bursting in 2000/2001, as well as the global financial crisis of 2007/2008.

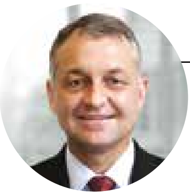
During the same two decades, the US consumer price index increased by a total of 54.8%, which means that an investment in the S&P 500 provided a compound real return of circa 2.2% p.a. over the full period (i.e. adjusting for the effect of inflation).

Once again, as we have articulated on numerous occasions, I come to the obvious conclusion, which is to ***remain invested in the market for the long term***, and the old adage that

> it's not ***timing*** the market, but rather ***time in*** the market that delivers superior investment returns in the long run.

This is the investment philosophy that we at Credo have continuously espoused ever since we started 20 years ago and continue to promote as we peer through the mist currently fogging our windscreen. (See the next article by Deon Gouws, our CIO).

I would like to end off this introduction by strongly suggesting that clients not only remain invested, but also take advantages of the period when stock markets around the world go on sale. ■



Deon Gouws - *CIO* | @DeonGouws_Credo

Good news turned

A number of clients have been asking for our thoughts in the wake of turbulent financial markets over the past couple of months, in particular following Wednesday 10 October when the US market fell more than 3% in a single session. At the time of writing, the S&P 500 is trading at a level some 7% below its all-time high which was reached in the second half of September.

Firstly, we would like to reiterate that we are long-term investors at Credo, and we try to ignore most of the shorter term noise and volatility.

Accordingly, we try not to get worked up too much when we see drawdowns that are ultimately considered to be normal in financial markets. In this regard, two summary statistics stand out – as pointed out in separate blog posts / tweets by US financial advisors *Michael Batnick* and *Charlie Bilello* recently:

- Going back to 1900, **a daily decline of as much as 4%** (or more) in the US stock market has happened on average **once every 82 days**; and
- This is the **23rd correction in the S&P500 of 5%** or more **since the recent March 2009** stock market low.

Having said that, we also accept that the long term is the sum of the short term, hence we'd like to offer some points of commentary in the wake of this recent volatility.

Firstly, it should be borne in mind that financial markets – especially equities – have been in expensive territory for some time now; we have been pointing this out to clients in an attempt to manage expectations. In fact, we were probably early when we started making this point a few years ago; having said that, it has always been our philosophy that one should stay invested through the cycle and we never try to time the market, so clients have benefited from strong markets in the past, in accordance with asset allocations that reflect their agreed risk profiles. When a market correction takes place as we've seen over the past few weeks, one can thus argue that it is in fact a healthy development, at least to some extent: shares end up being less over-priced as a result, enhancing the returns outlook going forward from this point onwards (especially relevant to those who may be putting "fresh" cash at work now).

In trying to offer reasons for the sell-off, it needs to be pointed out that the "good news has started turning into bad news", specifically as far as the US market is concerned. Whether or not one is prepared to give President Trump any of the credit (most of the positive momentum started a number of years ago, i.e. during the Obama days), it has become evident in the past few months that the American economy is now healthier than practically anytime in the last two decades or more: unemployment is at all-time lows, as a result disposable income is up and consumer confidence is high.

This is likely to have an accelerating impact on inflation, hence the Fed is expected to respond in the form of interest rate increases that could end up being more in number and ultimately higher in level than previously anticipated; in turn, this has started being reflected in the yield curve, with US 10 year rates now being in excess of 3% (higher than any time since the global financial crisis). Ultimately, interest rates are relevant in terms of discounting future returns from any investment, hence higher rates translate into lower capital values – which explains inter alia stock market declines.

into bad news?

Should one turn bearish as a result? The other side of the coin is simply to focus on the good news itself, i.e. a stronger economy should lead to increased profitability which is obviously good for share prices once all is said and done… the trick is simply to identify those sectors and companies that are likely to benefit quickest and/or most.

Speaking about profitability, the same Charlie Bilello referred to earlier, also pointed out recently not only that overall S&P 500 earnings are expected to increase by as much as 26% this year, but also that, if this expectation is in fact met and the index ends the year at current levels, its P/E ratio would go from 21.4 to 18.3; this would be the first year of multiple contraction since 2011.

We'd also like to point out once again that we are value investors at Credo, and as a result we are not invested in some of the sectors that we have considered to be the most overvalued, specifically the so-called FANG stocks (Facebook, Amazon, Netflix and Google) – all of these are down well into the double digit percentages from their highs in an overall market which is "only" 7% down from the top. If nothing else, this should help the relative performance of our portfolios as we live through a market dislocation. As financial author Jonathan Tepper tweeted in tongue-in-cheek fashion in October: you can pick up bargains in this sell-off... Netflix is trading at 104x EV/EBITDA and 80x forward P/E (this stock has declined even further since then, and is now trading more than 25% lower than its all-time high a short four months ago).

One more thing: we have always steered clear of direct emerging market exposure in building our discretionary equity portfolios at Credo, simply because we do not want to incur unnecessary risk for a small uplift in potential return in our portfolios that are designed to be relatively low risk. In the past few months, this has also proven to be value-adding, as emerging markets from Argentina to China to Turkey have gone through a particularly torrid time (both in terms of currencies as well as individual securities).

Which brings me to the main question: what should investors do at a time like this? Our advice is always the same: on the basis that one had a diversified portfolio of good quality investments (bought at reasonable prices) to begin with, the best strategy is to ignore the volatility and to sit it out until markets recover. The worst thing to do would be to "blink at the bottom" and sell out at the worst possible time (and of course no-one knows exactly when markets will start to turn again). For those with extra cash to deploy, this may be a good time to start "nibbling" again.

Jack Bogle, founder and retired CEO of Vanguard, recently said: ***"I spend about half of my time wondering why I have so much in stocks, and about half wondering why I have so little."*** Market participants may be nodding their heads in agreement to the first half of this quote today… but as night follows day, the time will come when you worry more about the second part again.

PS: Why do we tend to focus mostly on the US market? Simply because it is by far the biggest and most important market in the world, and still represents approximately 50% of most global benchmarks; accordingly, it also represents about half of the discretionary equity portfolios that we manage at Credo. We could have focused on alternative indices such as the MSCI World, but the main conclusions would be exactly the same. ■

Happy UCITS 1st Anniversary

In July 2017, Credo launched new funds building on our long-term track record. These are UCITS funds, authorised and regulated in Ireland and further approved in both the UK and South Africa by the FCA and FSCA respectively.

Jarrod Cahn - *Director*

GLOBAL EQUITY FUND

A year since its launch in July 2017, the Credo Global Equity Fund has returned 4.4% against its benchmark, the MSCI World Index, which returned 8.7%*. The Global Equity Fund follows a primarily bottom up, value-based approach to investing and has a strong bias towards developed market, large-capitalisation equities. The Fund looks to hold between 35 – 50 names in the portfolio, across various countries, sectors and industries. ***We aim to own quality companies that screen cheaply either against their own previous valuation or against the market.*** Mean reversion is a core belief in our investment strategy.

Against this backdrop, it has been well documented how momentum and growth investing have outperformed value as an investment style for most of the past decade. Over the past 18 months, for example, the MSCI World Growth Index has outperformed the MSCI World Value Index by more than 19%.

What is even more concerning, is that when stripping back the performance of the best performing major indices (particularly those in the US), a large percentage of that performance has come from a narrow band of stocks, predominantly within the technology sector. As value investors, all we can do is stay patient and true to our investment style, screening and buying stocks that look intrinsically cheap, either against historic valuation or the overall market as noted above.

A good example of this is a stock like Whitbread, which we added to our equity portfolios following the EU referendum vote. The thesis at the time was twofold: as the pound weakened, we expected more tourism to be attracted to the UK, which would benefit the hotel side of its business. But more interestingly, our analysis showed the Costa Coffee side of the business looked significantly undervalued against its peer group, and with the correct operational roll out and expansion of the brand across further parts of the UK and internationally, there was considerable growth potential. This view was recently vindicated with the news that Coca-Cola made an offer to acquire Costa, leading to a significant appreciation in the Whitbread share price.

Another aspect that deserves highlighting is the obvious benefit of any fund with a global outlook; namely one that has the reach to invest in international stocks, particularly those in the US (where equity returns have been better than in the UK and Europe for some time now). This unconstrained approach also gives us the benefit of owning some of the best companies in the world, where business models, brand awareness, corporate governance and leadership is second to none.

As we move into the last quarter of the year, and as at the time of writing, there certainly seems to have been a rotation taking place in world equity markets. The Trade Wars between the US and China, coupled with rising yields on US Treasuries, have spooked the markets. Emerging markets have sold off, risk appetite has diminished, but probably most importantly for our Global Equity Fund, we have seen a significant rotation out of growth stocks back into value stocks.
Although this does not mean that the Global Equity Fund will be unaffected in periods of significant drawdowns in the equity markets, one would expect better protection on the downside, and hence outperformance against its benchmark.

(*) Performance of the Class A (GBP) Retail shares from 03/07/2017 to 03/07/2018. Source: Bloomberg.

Rupert Silver - *Director*

DYNAMIC FUND

A year since the launch of the Credo Dynamic Fund, we are pleased to report positive fund performance of 10.7% compared to a benchmark of peers (IA Flexible Sector) which returned 5.0%*. The Dynamic Fund outperformed global equity markets and UK stocks even though the total return from bonds was, at best, negligible. Thus far, we have captured the vast majority of the upside when the market ran and have protected capital in deteriorating market conditions due to the more defensive nature of the bond holdings.

A key differentiator of the Dynamic Fund is it invests in both bonds and equities, enabling us to allocate capital where we see the best risk-adjusted returns and to be malleable to market conditions. Over the years Credo has invested and benefited greatly from both asset classes. Therefore, we thought it was important to run a fund under the same mandate. Unlike a balanced fund, which tends to hold an equal amount of bonds and equities, the Dynamic Fund has the flexibility to allocate capital depending on our view of the world and markets. We can take up to 90% exposure in either asset class although it is important to note that in practice this will only occur in very rare market conditions, if at all.

Another differentiator is our ability and preference to invest across the spectrum of market capitalisations. Big, of course, can be beautiful, and typically contains less surprises if things turn nasty. The large-capitalisation universe is, however, highly analysed and meticulously covered so when we judge conditions to be appropriate we look at mid and even small-capitalisation stocks for special situations and undiscovered jewels; and we leave the large-capitalisation stock picking to other teams. Within smaller companies, we also have access to management and we believe looking into the white of their eyes helps us gauge their tone and potential prospects. We are cognisant that being relatively size agnostic can cause periods of increased volatility; we believe, however, that over the long-term this will add significant value and the bonds held in the portfolio should aid in dampening any volatility.

Furthermore, we run a core and satellite approach within the Dynamic Fund, where we consider roughly 75% of the assets core holdings. These investments are in the main akin to Credo's core investment philosophy which is long-term, and value orientated. We aren't slaves, however, to a value model and do have a healthy dose of growth especially when we feel the valuation is appropriate. We believe the core will stand the test of time and we would envision adding to this on weakness. There is minimal turnover in these investments. Even though trading costs are low, we recognise overtrading can hurt performance in the long-term. The core holdings consist of bonds that we will buy and hold until maturity, solid equities that we trust to deliver over time and exposure to low cost tracker funds. In the satellite portion of 25% we somewhat relax the core philosophy and tactically add more transient positions. The rationale for the satellite portion varies; it could be a short-term pricing situation, an attractive new issue, a catalyst specific to a stock or a sector or it might just be a case of momentum. Predicting more challenging market conditions is notoriously difficult if even possible but we have experienced bear markets before and will most certainly know when we are in its grip. In this scenario we intend on rotating the satellite portions into more defensive investments such as high quality short-dated bonds.

Looking forward, the period of synchronised global growth is appearing to stutter or, at the very least, become more uncertain. As the earnings boost from tax reforms begins to fade moving into the last quarter of 2018, the market may begin to focus on President Trump's erratic nature, unpredictable tweets on trade wars and the slow unwind of the global monetary expansion. As a result, we have increased our allocation to bonds to around 35% especially as returns have become more attractive.

We continue to believe that after 9 years of a bull market, one must be cognisant of the risks, but also note that this has been the most reluctant bull market for many years and subsequently it is very difficult to call. ***We believe the Dynamic Fund is well-positioned to deliver strong relative return across different market environments and, over the long-term, we continue to believe we can adapt to deliver attractive returns for investors.***

(*) Performance of Class A (GBP) Retail shares from 03/07/2017 to 03/07/2018. Source: Bloomberg and Morningstar.

Ben Newton - *Investment Manager*

Dynamically navigating the IPO market

Within the Credo Dynamic Fund, we look to build a diversified portfolio of assets. As managers of this fund, we have the flexibility to access investments across a wide spectrum of asset classes and have access to the full range of building blocks, balancing investments between single line equities and bonds whilst selectively using collective investment schemes to access the expertise of third party managers or to benefit from low cost diversification.

Cognisant of the fact that global capital markets have had a strong run since the financial crisis and bearing in mind the changing trajectory in global monetary policy, one must be mindful of potential risks on the horizon. Subsequently, we are always looking for ways to diversify, while sticking to our belief that there is significant value in the compounding returns of being invested over the long term. As UK-based investment managers, we are mindful of the Brexit and Corbyn risks which have taken hold but have faith we can still add substantial value by finding under-researched companies within small to medium capitalised equities in the UK. The Dynamic Fund currently holds approximately a quarter of the portfolio within this category and the fund has selectively invested in several "off the radar IPOs" that have contributed significant value to our investors. Within the new issues one must be very discerning. We have avoided many of the high-profile IPOs, as stocks can come to the market with unrealistic expectations to aid sellers in realising value. Three such "off-the-radar" IPOs that have worked well for the Dynamic Fund are:

Arena Events Group plc

Arena, the Dynamic Fund's largest holding within this category, is a global events solution company implementing a high-quality service that has earned the trademark of "Arena" standard within the industry. Arena's contracts include many globally renowned events, including the contract to provide temporary seating and corporate tents to both the Wimbledon and PGA Championships. This category of events should prove resilient regardless of the economic climate. The growth comes from a combination of contract wins, margin enhancement and bolt-on acquisitions in a highly fragmented market. One such example is the acquisition of an ice rinks business, which has contracts at some familiar locations such as Hyde Park's Winter Wonderland and the Natural History Museum, reducing Arena's seasonality and subsequently aiding its margin. This strategy is leading to significant growth in earnings for Arena, whilst its share prices remains on attractive

...we look to build a diversified portfolio of assets. As managers of this fund, we have the flexibility to access investments across a wide spectrum of asset classes and have access to the full range of building blocks...

valuations on all metrics and pays a reasonable dividend. Arena is one of the Dynamic Fund's top 10 investments and we continue to see significant value at these levels.

Team17 Group plc

Team17 is a leading video games label born out of the team that developed the much-acclaimed Worms franchise, partnering with independent developers to produce high quality finished products across multiple platforms. Their methodology is like an investment committee or Dragon's Den of lifetime gamers. Over 600 games have passed through their due diligence process, but the team has only selected nine development projects to progress. As the group grows, it will continue to broaden its portfolio and we are confident they will continue to find more undiscovered gems in a similar vein to "The Escapist" or "Overcooked", which proved extremely popular. Optically, the stock looks expensive after a 60% return since listing, but we remain comfortable with the holding and will continue to back the management team of this market leader over the longer term in a sector with strong fundamentals.

Knights plc

In 2011, UK legislation was changed to allow non-lawyers to manage and own legal practices and has subsequently led to several of these practices listing on public markets. This is an interesting sector, as it is typically not overly cyclical and is ripe for disruption, allowing lawyers to fully focus on their profession and expertise. Knights is a leading regional law firm operating in a highly fragmented market, offering top-tier service from a regional cost base. The firm is led by David Beech, the CEO and majority shareholder, who has a strong background as a lawyer and in private equity. Knights meets our investment requirements as it has approximately 70% recurring revenue, economic resilience, high growth prospects, and the valuation remains attractive relative to the underlying growth (despite strong performance since the IPO).

These examples illustrate the broad depth of investments within UK capital markets and that not all UK equities should be painted with the same brush under the current political cloud. Within the Dynamic Fund we will continue to use our flexibility to the advantage of investors, using IPOs to build on the Fund's strong start to life.

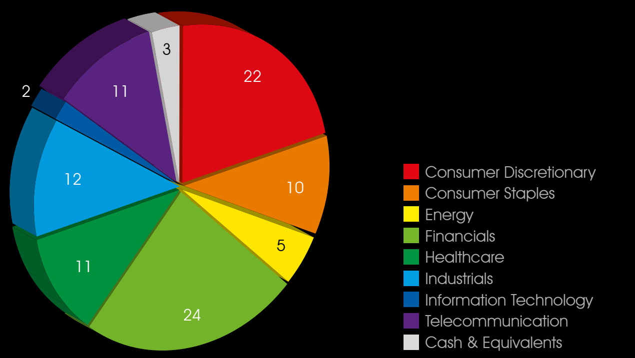
Kathryn Linde - *Relationship Manager*

One year of UCITS funds

GLOBAL
EQUITY FUND

Credo has a strong track record of managing long-only, value-based, direct equity portfolios with a bias towards developed market, large capitalisation stocks. The Fund provides an actively managed, unitised structure through which to gain exposure to this philosophy. Our aim is to generate sustainable excess returns versus global market indices.

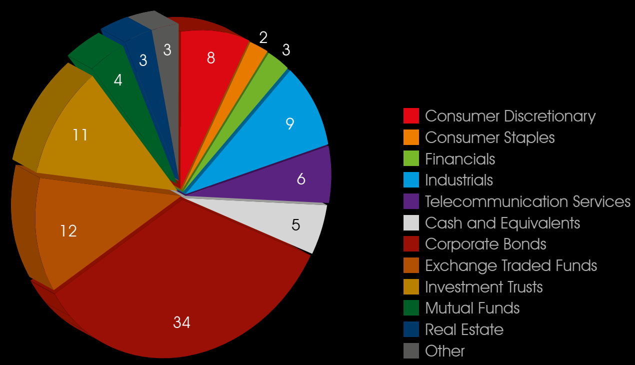
Sector Allocation (%)



DYNAMIC
F U N D

Utilises the long-term and successful investment strategy that has historically been employed within the traditional stockbroking arm of Credo, and aims to achieve a balance of income and capital growth over the longer term. The Fund has flexibility to invest across asset classes depending on prevailing market conditions.

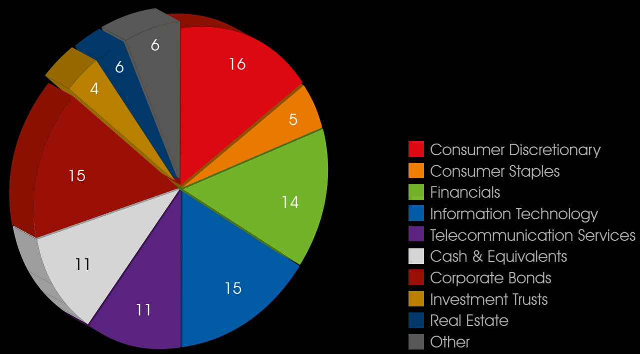
Sector Allocation (%)



GROWTH
F U N D

A reflection of the Fund Manager's (Roy Ettlinger) personal investment style and strategy which he has successfully adopted for clients in past years. The Fund aims to provide attractive risk-adjusted returns and also has the flexibility to invest across asset classes.

Sector Allocation (%)



Currency Allocation (%)

GBP	29.0
USD	60.0
Other (AUD, HKD, SGD, EUR, MXN)	11.0

Past Performance (%)

1 Month	-1.1
3 Months	4.3
1 Year	8.3
Since Inception	8.0

Top 10 Holdings (%)

HCA Healthcare Inc	Healthcare	4.8
Cigna Corp	Healthcare	4.6
Prudential plc	Financials	4.5
Verizon Communications Inc	Communication Services	4.5
Wells Fargo & Co	Financials	4.4
AIA Group Ltd	Financials	4.2
Chubb Ltd	Financials	4.2
GVC Holdings plc	Consumer Discretionary	3.6
Paddy Power Betfair plc	Consumer Discretionary	3.6
The Walt Disney Co	Communication Services	3.6

Currency Allocation (%)

GBP	88.0
USD	10.0
Other (HKD, CAD, EUR)	2.0

Past Performance (%)

1 Month	0.0
3 Months	0.6
1 Year	8.1
Since Inception	11.4

Top 10 Holdings (%)

iShares Core MSCI World UCITS	Exchange Traded Funds	5.1
Nationwide Building Society 10.25%	Corporate Bonds	3.3
Co-Operative Group Ltd 11%	Corporate Bonds	3.0
Arena Events Group plc	Industrials	2.9
Pacific Horizon Investment Trust	Investment Trusts	2.4
Cineworld Group plc	Communication Services	2.3
BB Healthcare Trust plc	Investment Trusts	2.2
Metro Bank plc 5.5%	Corporate Bonds	2.1
Helical Bar Jersey Ltd 4%	Corporate Bonds	2.0
Intermediate Capital Group 7%	Corporate Bonds	1.9

Currency Allocation (%)

GBP	59.0
USD	39.0
Other (HKD, EUR, ZAR)	2.0

Past Performance (%)

1 Month	-0.8
3 Months	2.3
1 Year	10.1
Since Inception	10.9

Top 10 Holdings (%)

Amazon.com Inc	Consumer Discretionary	4.6
Microsoft Corp	Information Technology	3.3
Costco Wholesale Corp	Consumer Staples	3.2
Berkshire Hathaway Inc	Financials	2.9
Cineworld Group plc	Communication Services	2.8
Alphabet Inc	Communication Services	2.6
Investec Bank plc 4.25%	Corporate Bonds	2.5
SSP Group plc	Consumer Discretionary	2.2
Mastercard Inc	Information Technology	2.2
Visa Inc	Information Technology	2.1

Source: Société Générale Securities Services (Ireland) Limited as at 28/09/2018. Inception date: 03/07/2017.

Alan Noik - *MD* | @AlanNoik_Credo

How safe are your assets?

The role of the custodian

Clients often ask us about the role of the custodian and what they add to the overall value chain of investments (which also has a bearing on what one pays for custodial services).

A custodian is a specialised financial institution responsible for safeguarding a client's financial assets and is not engaged in "traditional" commercial or consumer/retail banking such as mortgage or personal lending, branch banking, personal accounts and so forth.

The role of a custodian in such a case would be to:

1. Hold in safekeeping assets/ securities such as equities, bonds, commodities and cash;
2. Arrange settlement of any purchases and sales and deliveries in and out of such securities and currencies;
3. Collect information on and income from such assets (dividends in the case of equities and coupons (interest payments) in the case of bonds) and administer related tax withholding documents and foreign tax reclamation;
4. Administer voluntary and involuntary corporate actions on securities held such as equity dividends, stock splits, business combinations (mergers), tender offers, bond calls, etc;
5. Provide information on the securities and their issuers including providing the notices of annual general meetings and proxy forms;
6. Maintain currency/cash accounts, effect deposits and withdrawals and manage other cash transactions; and
7. Perform foreign exchange transactions.

The custodian's single most important function is to safeguard your assets and therefore it is critical to properly assess the custodian's balance sheet and, as well as something which is often disregarded, its business model.

Have you properly assessed your custodian risk?

Many investors take for granted that their investments are safe and secure. This is something Credo takes very seriously and we have consistently, over the past 20 years, focused on providing our clients with a safe, robust and secure environment in which to hold their assets.

These are some of the questions that you should be asking of your wealth manager or stockbroker:

1. Does the custodian offer Contracts for Difference (CFDs) which are often highly leveraged?
2. Does the custodian have exposure to derivatives such as futures?
3. Does the custodian offer margin lending on shares?
4. Does the custodian lend out your stock to other clients?

A 'Yes' to any of the above

questions could ultimately compromise the safety and security of your assets. In appointing Pershing Securities Limited as our primary custodian, we are comfortable that none of the above questions raise any concerns as the answers to all of them is an emphatic 'No'.

Pershing is part of The Bank of New York Mellon Corporation, the world's largest custodian and AA rated bank, with a long history of expertise and experience in custody services.

Our holistic approach to risk

Although there are no zero risk options within the financial services industry, our custodian, Pershing, takes the approach of providing the maximum number of protections available to our clients to provide the greatest possible assurance.

Pershing's focus as a business is ensuring the safety of the investors' assets. They have no competing priorities, it's the only thing they do and we believe they are the best at what they do.

Pershing provides a safe, robust model for holding and protecting investor assets. They operate from a very strong capital position, they have proven expertise in the safeguarding of investors' assets and have a well-developed and holistic risk management framework.

The administration regime

We appreciate the recent high-profile case involving Beaufort Securities has caused concern amongst investors as it demonstrated that ring-fencing and segregation of assets do not prevent the collection of the administrator's or liquidator's fees out of investors' assets. Under the rules that control client money and safe custody of assets (CASS rules), custodial assets are segregated from the assets of the custodian.

In the event of the custodian's insolvency, custodial assets are not available to the creditors of the custodian or to the administrator. The flipside of this position is that the work required by the administrator to return assets to the investor cannot be funded by the custodian's own assets and English law (most recently under the Special Administration regime) recognises that such work would need to be funded from the investors' assets themselves. Contrary to media reports, this position is the result of the assets being segregated and held by the custodian on trust and does not represent a breach or cancellation of CASS protections. Moreover, any losses suffered by clients as a result of their funds being used to settle such costs, can be reclaimed from the FSCS.

Importantly, in a situation where Credo became insolvent, our administrator would not have a right to recover its costs from investors' assets as the assets are not held by Credo but rather by our custodian, Pershing.

The protection of investor assets is at the forefront of our service model. We operate under a "fully disclosed/ Model B" framework providing a tripartite contract between Pershing, Credo and our clients. This means the assets are held by Pershing, as custodian on behalf of the investor. Under this agreement, each investor is fully identified in Pershing's books and records and recognised, as the beneficial owner of those assets which are fully segregated from Pershing's own assets (and from Credo's assets). In addition to risk capital Pershing has additional insurance policies in force to protect against financial loss caused directly by certain events.

Low cost trading platforms

We are regularly asked by existing and prospective clients, how some of the online trading platforms are able to offer trading services and custodial services at such low cost. It's no secret that these low-cost platforms profit primarily from stock lending, providing margin facilities for highly leveraged CFDs and other derivative based products and making a spread on more illiquid stocks. These activities carry with them inherent risks and investors who use those platforms should be aware of those risks.

The fact that our custodian provides none of these services means that the underlying counterparty risk is greatly reduced, allowing our clients to sleep easy at night knowing their assets are safe and secure. Not being able to earn anything from such activities, Pershing can however not style itself as a "discount" option and this explains why they need to charge a headline fee for the services and the security they provide.

At Credo, we understand the importance to our clients that their custodian has the protection of client assets at the centre of their focus. This is our partner Pershing's major strength, as the market leader in the provision of custody services.

Ainsley To - *Research Analyst* | @AinsleyTo_Credo

From cradle to grave

Capitalism in the 21st century

Earlier this year, Apple and Amazon became the first stocks to surpass $1 trillion in market cap (if only for a brief period of time in the latter's case). The world economy has gone through extraordinary changes in the last decade and these two companies have been perfectly positioned to benefit. Unlike the evolutionary process in nature, financial markets move much faster and it doesn't take centuries to see dramatic changes. A look at the largest companies in the world every decade since 1990 shows a remarkable lack of consistency – with a few exceptions, it has been very difficult to maintain dominance in a rapidly changing world.

A close look at the table can discern some distinct themes in each decade: the Japan bubble in the 90s, Technology, Media, and Telecom stocks in 2000, the peak of China and the commodities cycle in 2010, and the technology driven society today. The high turnover during each decade highlights the unpredictable nature of capitalism. Half of today's top 10 companies did not even exist back in 1990… and betting that it will be these same companies in a decade's time, is to bet against change, and thus to bet against history.

History is written by the winners

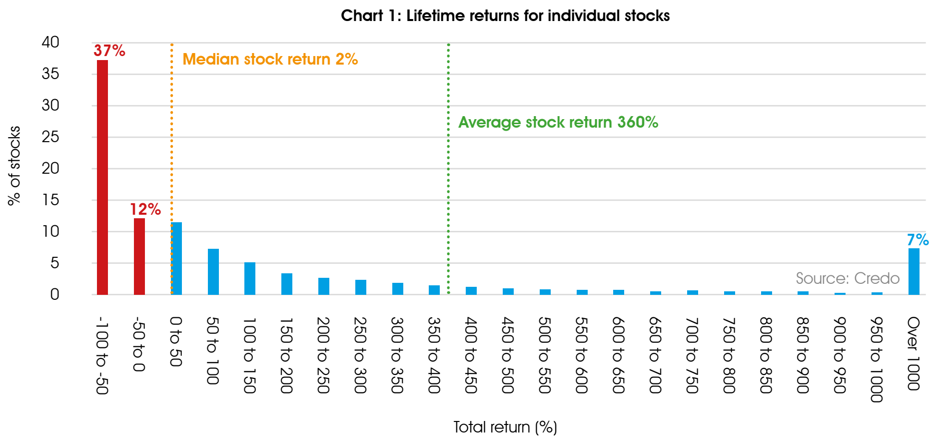
Historically, most companies weren't born at the top of the food chain - they had to climb to the top. And many stocks never made it there. When looking at US data[2] (which has the richest history), of the 6,667 listed stocks in 1990, 84% of them had been delisted by 2018. Chart 1 shows a count of the lifetime returns of stocks, dead or alive, since 1990. **50%** of stocks didn't manage a positive total return over the period and 37% of them lost more than half of their value. The median life of a stock during this period was 6 years and the **median lifetime total return** was only 2% - that is to say most stocks earn a return worse than cash over the course of their existence! This phenomenon is not just a recent one, as studies note similar results as far back as the 1920s[3]. It instead appears to be a function of how capitalism works. This is counter intuitive for many investors as conventional wisdom dictates that investing in equities has produced significant real returns in both recent and long-term history. The key to reconciling these conflicting ideas - that over time the overall market goes up but most stocks are poor investments - is to analyse the winners.

The lifetime returns data is a positively skewed distribution with a long right tail. Even though the **median** stock had such a low lifetime return, around 7% of stocks returned over 1,000% during their lifetime. This small number of extreme winners dramatically increased the **average** lifetime return of stocks. Because they are small in number, the likelihood of picking an individual winner out is low (only 16% of companies have returns above the average, e.g. are to the right of the **green** line). However *if you miss these outliers, then you*

Top 10 largest companies[1]

1990	2000	2010	2018
Nippon Telegraph	Microsoft	Petrochina	Apple Inc
Bank of Tokyo-Mitsubishi	General Electric	Exxon Mobil	Amazon
Industrial Bank of Japan	NTT Docomo	Microsoft	Microsoft
Sumitomo Mitsui	Cisco Systems	ICBC	Alphabet
Toyota	Walmart	Walmart	Berkshire Hathaway
Fuji Bank	Intel Corp	China Construction Bank	Facebook
Dai-Ichi Kangyo	Nippon Telegraph	BHP Billiton	Alibaba Group
IBM	Nokia	HSBC	Tencent
UFJ Bank	Pfizer Inc	Petrobras	JP Morgan Chase
Exxon	Deutsche Telekom	Google	Johnson & Johnson

(1) Source: Bloomberg. (2) All common shares and ADRs in the CRSP database between 1990 and June 2018.



miss out on the majority of the equity risk premium.

This dynamic perhaps provides some insight into why many investors find it is so difficult to outperform the market. A concentrated portfolio with bigger positions in fewer stocks is at risk of missing out on the small number of winners that generate the majority of the entire market's performance. Whereas the whole market is guaranteed to include these outliers and their outsized returns make up for their smaller position size. To highlight the impact that capturing these winners can have, one can compare the lifetime returns of individual stocks to a proxy for the market, such as the Russell 3000 index: over the same time periods, 70% of stocks underperformed the index over their lifetime, with the median stock lagging the index by 10.2% *per annum*.

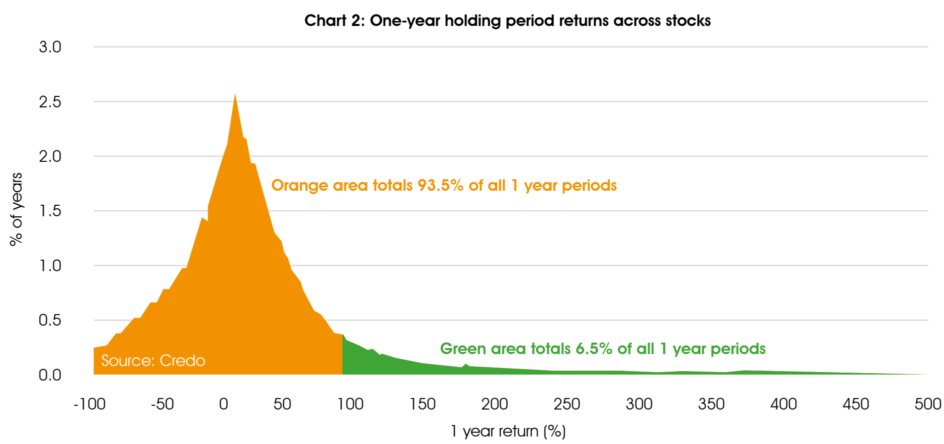
The right place at the right time

Part of the reason for positive skew in lifetime returns is due to the effect of compounding over the course of a stock's life, which is less relevant for most investors since they rarely hold a company from cradle to grave. However, even when looking at the same individual stock data but for annual holding periods (Chart 2), we see this distribution also has a long right tail. In the **majority** of years, stocks experience between -100% and +100% returns. However, there are **occasional** periods when a stock gains significantly more than 100% in a single year. The outliers within the green area of Chart 2 actually extend beyond the limit of the chart, with 0.35% of years being above 500%, and the best calendar year for any stock in the period returning 11,060%!

The payoff profile for successfully picking these small number of stocks during these specific years resembles a lottery ticket – extremely high potential reward but extremely low likelihood of winning. This type of reward is very attractive for most investors from a behavioural perspective, which leads to a majority of investors being short term and under-diversified. Portfolio concentration will undoubtedly produce the highest return in the best possible scenario, but the most likely scenario is a poor outcome.

Conclusion

Capitalism, like playing the lottery, is often a losers game – whilst it tends to produce a small number of extreme winners, the median outcome (the most likely outcome for the majority of investors) is unattractive. Investors often only view diversification through the lens of managing downside risk but we hope to show how it applies equally to opportunity cost – by reducing your chance of missing the largest opportunities when they come along. A diversified portfolio combined with a long time horizon will cast the widest net possible to capture the unpredictable forces of creative destruction when they choose to reveal themselves.



(3) "Do Stocks Outperform Treasury Bills?" - Bessembinder, 2017.

Trevor Black | @trevorblack

Value from a 90s darling

Active management doesn't mean activity just for the sake of it. The goal is good long-term performance, without taking unnecessary risk. Our time horizon is not fixed. We hold some stocks for long periods, and some stocks relatively briefly. **The consistent focus, however, is to keep looking through the noise in an attempt to deliver value.** On average, the noise tends to come out in the wash over the course of two to five years in most instances as fundamentals end up taking charge. We have however been holding Microsoft in the *Best Ideas Portfolio* for even longer than this, namely since inception of the portfolio more than seven and a half years ago.

Microsoft is a household name. At its peak in the 90s (December 1999), the company was valued at more than 4% of the market capitalisation of the S&P500. Since the early 1990s, Microsoft dominated the personal computers market, first with MS-DOS and then with Windows. 1990 saw the birth of Microsoft Office, which is still ubiquitous in the workplace. The 90s also saw a decade of legal clashes with the Federal Trade Commission. Large companies get a lot of attention as regulators try to decide whether their power benefits, or harms, consumers.

Since the 90s, Bill Gates has moved on to focus on philanthropy. He stepped down as chief executive officer in January 2000. Gates later also stepped down as Chairman in 2014. Peaking at $58.75 a share in 1999, the stock fell as far as $15.15 by February 2009. A decade of pain can kill even the most persistent of supporters. Along with the legal battles, the rise of Google, Facebook, Amazon and Netflix also removed the idea that one company could completely dominate a digital future with no checks and balances.

Analysing the fundamentals of businesses is complex. The Microsoft story is a great example of three things that really matter – valuations, earnings growth, and management.

Price is not value. But what you pay for something matters. After launching Windows in the mid-90s, earnings accelerated, and Microsoft became a market darling. From a price of around 22 times earnings in 1994, the peak in 1999 saw shareholders paying 60 times earnings, implying very high expectations as far as future earnings growth was concerned. Subsequently earnings did grow impressively; just not as fast as had been justified by the over-optimistic valuation. As a result, the price earnings ratio dropped from 60 times in 1999 bottoming at approximately 9 times earnings in 2011. This de-rating more than offset the earnings growth over the period. It is noteworthy that after the share price peaked in 1999 near $59, it would not reach those same levels until 2016 - 17 years later!

We do not advocate just buying something because it is cheap. We don't blindly divide price by earnings (P/E) and pick the lowest number. Our focus is on calculating the intrinsic value, looking through the current noise and having a longer time horizon than most sell side analysts.

...the consistent focus, however, is to keep looking through the noise in an attempt to deliver value...

Sell side analysts make recommendations about buying and selling, but don't become owners themselves. This can limit the time frame over which they are judged. We look towards the longer-term earnings growth potential. We look at whether the multiples investors are being asked to pay for the earnings are justified. We look at the dividend yield we can pocket while we wait.

When we bought Microsoft in 2011, we did so because the valuation looked extremely attractive relative to the long-term earnings potential. Bear in mind that by then, Microsoft was no longer a market darling.

Until a few years ago, the market worried about Google's free Chrome operating system. They worried about competitors stealing market share from Microsoft. We felt that Microsoft Office and Windows had a strong, defendable moat. A network effect means cooperating is easier if people are using the same software. Corporates tend to know how to use Excel and Word, and have everything saved in those formats. Shifting has a cost, and stickiness makes change a challenge. Only very price sensitive consumers brave the change.

The rise of smartphones also had investors worried about declining personal computer sales. We felt that this shift would be temporary and sales would stabilise as smartphone penetration peaked.

These worries provided us with an opportunity, in the same way the optimism of the late 90s should have inspired caution.

Another factor in addition to what you buy and what you pay for it, is who will be driving. The chief executive officer that had taken over from Gates had not done a great job: Steve Ballmer had, in our opinion, made some major missteps in missing the opportunity to buy Android, prioritising Windows rather than cloud-computing, and making poor acquisition decisions (Nokia). He had however been in place for over a decade, and was nearing retirement age.

In 2014, Satya Nadella took the reigns as CEO. The combination of an attractive valuation, strong growth, and an excellent management team has meant that we have been able to hold Microsoft for an extended period. We have seen the share price go up more than 3 times since we originally bought it in client portfolios, and we are happy to continue holding the position.

We don't buy to hold, and we don't buy to sell. We buy with the intention of making attractive long-term returns. For that to happen, what you buy and what you pay, both matter. ■

Kathryn Linde - *Relationship Manager*

Diversified equity portfolios

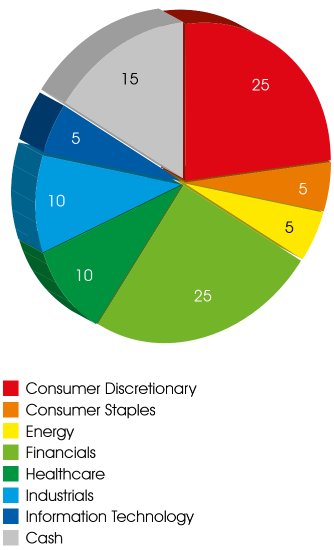
The Best Ideas and Dividend Growth portfolios are diversified global equity portfolios, which we believe to be well positioned to outperform the wider equity market over the longer term. The portfolios have biases towards developed-market, large-capitalisation stocks.

BEST IDEAS PORTFOLIO

Performance (%)

Return	
YTD	9.6
1 Month	0.6
3 Months	4.4
1 Year	17.3
Annualised Return	
3 Years	19.4
5 Years	14.0
Since Inception	12.9

Sector Allocation (%)

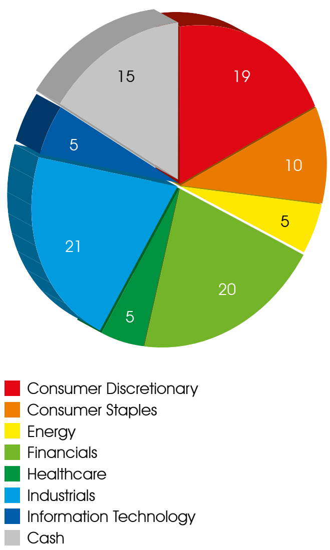


DIVIDEND GROWTH PORTFOLIO

Performance (%)

Return	
YTD	8.9
1 Month	0.4
3 Months	3.1
1 Year	12.5
Annualised Return	
3 Years	18.0
5 Years	13.9
Since Inception	15.0

Sector Allocation (%)

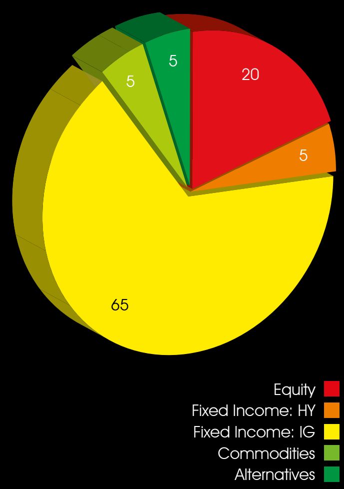


MULTI-ASSET PORTFOLIO 20/80

Performance (%)

Return	
YTD	1.8
1 Month	-0.3
3 Months	0.8
1 Year	5.3
Annualised Return	
3 Years	7.1
Since Inception	6.2

Strategic Asset Allocation (%)



Value orientated investment philosophy

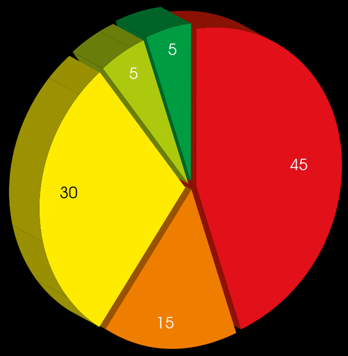
The Credo Multi-Asset Portfolios (MAP) follow an evidence based approach to investing, providing investors with diversified exposure to global assets through a selection of funds and ETFs. Funds are selected using Credo's in-house selection process and offered as four solutions targeting various levels of equity exposure. Portfolios are available in both GBP and USD.

MULTI-ASSET PORTFOLIO 45/55

Performance (%)

Return	
YTD	3.3
1 Month	-0.2
3 Months	2.1
1 Year	7.3
Annualised Return	
3 Years	10.6
Since Inception	8.3

Strategic Asset Allocation (%)

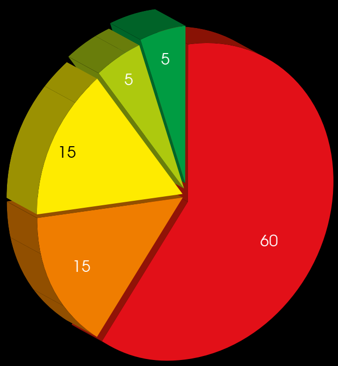


MULTI-ASSET PORTFOLIO 60/40

Performance (%)

Return	
YTD	4.3
1 Month	-0.1
3 Months	2.8
1 Year	8.7
Annualised Return	
3 Years	12.6
Since Inception	9.3

Strategic Asset Allocation (%)

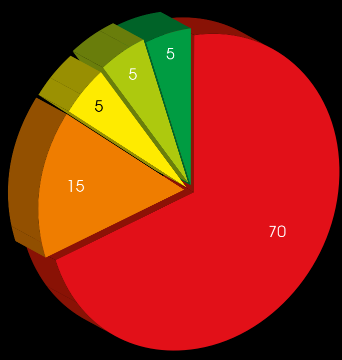


MULTI-ASSET PORTFOLIO 70/30

Performance (%)

Return	
YTD	5.0
1 Month	0.0
3 Months	3.3
1 Year	9.6
Annualised Return	
3 Years	13.9
Since Inception	10.2

Strategic Asset Allocation (%)



Performance figures are based on a notional portfolio, denominated in pound sterling, designed to track the holdings of the Credo Best Ideas, Dividend Growth and Multi-Asset portfolios. Portfolios incorporate all additions and removals. Portfolios may not be fully invested at a point in time and therefore can hold a portion of assets in cash. Performance is calculated before any fees (which can vary depending on the level of service) but includes gross dividends, reinvested. Following additions or removals, each holding is rebalanced to the model weighting. Source: Bloomberg pricing as of 30/09/2018 close. All portfolio performance is calculated using Bloomberg PORT, rounded to 1 decimal place. Inception dates: Best Ideas Portfolio 14/11/2011, Dividend Growth Portfolio 28/12/2012 and Multi-Asset Portfolios 02/07/2014.

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