CREDO NEWS

Issue 32 | February 2020

Reinventing growth
Jason Spilkin

Back to the future 2050
Ainsley To

...and more

What a difference a year makes

Deon Gouws

Through the looking glass

Jarrod Cahn

VISION2020

Protecting against the flu

"Dire as some of the human consequences of the coronavirus might be, we do however continue to believe that it should not have a material impact on the way in which we manage portfolios."

When Wall Street sneezes, the rest of the world catches a cold, according to an old market saying.

This has always been the case, given the size of the American market relative to the rest of the world. But it has become an even bigger risk over the past decade, given the astronomic share price growth of a few mega cap companies in the US.

Whilst there was not even a single stock in the world with a market capitalisation in excess of a trillion dollars as recently as a few months ago, there are now no less than four: Microsoft, Apple, Google (Alphabet) and Amazon. If one were to form an acronym out of the four company names, it would even spell MAGA – the same as Donald Trump's 2016 campaign slogan: ***"Make America Great Again!"***

The continued strength of what is now one of the longest bull markets in history has led many commentators to caution investors about an imminent sneezing fit… against this background, the question is:

how does an investor protect him or herself against a bout of market flu?

In his piece in this edition of CredoNews, Deon Gouws, Chief Investment Officer at Credo Wealth, reiterates our approach of ignoring most of the noise in the daily news-flow, whilst simply focusing on building well-diversified portfolios of quality assets acquired at reasonable prices. We continue to believe that this should prove to be a sound strategy in the fullness of time – even if the market catches the periodic cold.

It is commonly believed that the worst disease for fixed income investors are rising interest rates. This is a fear that has been particularly contagious given that interest rates start this new decade near all-time lows. Ainsley To, who is in charge of our Multi-Asset Portfolios (MAP), illustrates how the argument that rising rates are bad for bonds is more nuanced when considering a bond portfolio diversified across maturities, where the ability to reinvest both coupons and principal over time can often serve as a vaccine.

And what about hedging as a flu protection strategy? Whilst this is not something which we generally do in our directly managed equity and bond portfolios, it is in fact an approach which is preferred in Credo's MAP solutions – but only as far as fixed income currency exposures are concerned (as explained by Fund Analyst Calvin McLean in his piece).

In addition, Jarrod Cahn – responsible for managing the Credo Global Equity Fund (CGEF) – discusses a number of examples of successful stock-picking over the past year or so, all of which has led to a period of strong performance for the fund. Importantly, this has been achieved in accordance with our value-based investment approach with an emphasis on quality – a philosophy which we believe to be sound, especially if one were to worry about the odd market sneeze (given that the more expensive, growth-oriented stocks are likely to drop most in price in a possible correction).

Jason Spilkin, who manages the CGEF in conjunction with Jarrod, provides more colour on two of the major holdings of the fund, namely Disney and Microsoft, and explains how these companies have managed to re-invent growth over the past few years (ultimately leading to some very strong share price performance achieved by both).

Against this background, we are also very excited to announce the launch of a new fund within the Credo stable: the South African domiciled BCI Credo Global Equity Feeder Fund. It will invest solely in the existing Irish domiciled CGEF and allow SA investors who cannot (or do not want to) send money overseas to have offshore exposure – more about this in the piece by Andrew Cormack.

In closing, market flu is of course not the only virus that occupies our minds at present, and a very different type of flu has been making headlines of late: at the time of writing, more than 40,000 people around the world have been infected by the coronavirus over a five week period, and around 1,000 have died from the illness. Most of China is in lock-down as a result, and we will only know in the fullness of time how long this whole situation lasts.

Dire as some of the human consequences of the coronavirus might be, we do however continue to believe that it should not have a material impact on the way in which we manage portfolios. **Needless to say that we will continue to monitor the situation on behalf of clients, and take action (and communicate accordingly) if and when we deem necessary.** ■

Deon Gouws - *CIO* | @DeonGouws_Credo

What a difference a year makes

"If we thought we were living in interesting times a year ago, the world is probably an even more interesting place today."

At the beginning of last year, we sent out a piece to clients under the heading **"Living in interesting times"**.

This followed one of the most turbulent quarters in markets since the global financial crisis, with the S&P 500 reaching an all-time high in September 2018 before promptly shedding nearly 20% in the ensuing 3-month period. As a result, many investors were fearing an extended bear market a year ago, especially given that a number of strategists had been calling a "top" based on elevated valuation levels for some time before that.

Our response to this was similar to the messages which we've been sending out to clients whenever financial markets appear to take a breather:

it has always paid to remain invested for the longer term, so why change now?

A year later, we are therefore pleased to report that this strategy of staying the course (or adding to positions, for those who may have had additional cash to deploy) has once again paid off, with the S&P 500 adding some 30% over the ensuing twelve months and equities reaching numerous consecutive all-time highs throughout the last few months of 2019.

January 2020 started in similar vein: on the first trading day of the year, global equity markets closed at yet another record level. Whilst investment morale could hardly have been worse twelve months before, a much more positive outlook has certainly evolved since then, based on increased optimism that the much vaunted trade war between the US and the rest of the world (most notably China) appeared to move ever closer to resolution, as well as the fact that a global recession no longer appeared likely (in spite of some yield curve inversion and lots of worries in this regard a short few months before). At the same time, the US consumer was of course also benefiting from a significant wealth effect thanks to good employment statistics, record house prices and all-round strong markets.

Against this background, confidence levels were now at an all-time high and there was a growing consensus that 2020 was going to be another positive year for equities.

And then everything appeared to change, practically overnight, with the news that Iran's top security and intelligence commander was killed early on the 3rd of January in a drone strike which was authorised by Donald Trump. Suddenly, confidence evaporated from the market and all bets were off: equity futures turned negative and gold as well as oil prices spiked. Many people feared the worst; some still do.

It is at times like this that some investment strategists will argue for a "risk-off" approach, with lesser allocations to equities, for example. **But why tinker with your portfolio in the first place?**

Not to be flippant about the continued threat of strikes in the Middle East or the grave possibility of World War III (a term/topic which has of course been trending on Twitter), but we would argue that one probably has much more to fear from war itself than any perceived risk based on investment exposure? And if – cross fingers – the worst-case scenario does not play out on the war front, risk assets are likely to bounce back soon enough, and those that have "lightened" their holdings will just suffer opportunity cost once more.

In addition, bear in mind that we have been living with essentially this kind of geo-political risk for a few decades now, with multiple terrorist attacks around the world, for example. In spite of this, the global economy has kept on growing, free markets have survived, innovation continues apace, and a large number of companies have been and are thriving as a result. All of this has contributed to unprecedented stock market gains over the period.

As it happens, only days after the initial rumours of war, financial markets started to stabilise and global equities have been trading at all-time highs once again.

While all of this has been going on, other bad news started making headlines: the coronavirus started spreading across the world, infecting masses of people and killing many of them. China and Hong Kong went into effective lock-down overnight, and there is no doubt that this will have an impact on global economic growth. In spite of that, the financial market impact has been relatively muted to date and only time will tell how the situation plays out.

At Credo, one of the points that we emphasise as part of our investment philosophy is that **we aim to identify matters of strategic importance and focus on methodologies that have proven to be robust through a variety of market cycles, rather than fixating on short-term news-flow and forecasts.** Important as these issues may be for a whole host of reasons, I would suggest that even the developments in the Middle East as well as global pandemics ultimately boil down to examples of such short-term news flow which we tend not to focus on, therefore.

Consequently, we remain fully invested on behalf of clients in well-diversified portfolios of quality assets acquired at reasonable prices.

Does all of this mean that we have a bullish outlook for the year ahead? Not in particular; in fact, it would be remiss of us not to point out that markets are clearly not cheap compared to historic norms and hence we're always at pains to manage expectations accordingly. But by the same token we're not bearish either – we simply do not believe that any such ex ante view adds any value to a client's portfolio positioning.

If we thought we were living in interesting times a year ago, the world is probably an even more interesting place today. Which means that **the investment environment has probably become even more challenging – but only for those who tend to focus on the tumultuous news-flow, or try to base their strategy on forecasting a range of outcomes.** This is clearly a minefield if ever there was one… and definitely one which we will continue to avoid at Credo. ■

Reinventing growth

One of the ironies of successful equity investing is that many of the best companies don't necessarily foresee the exact path which will lead to sustained success over time. Instead, they institutionalise a robust approach that allows them to reinvent themselves for enduring growth.

At Credo, we accept that not every investment we make will lead to superior returns; we have thus established a process where we monitor risks and re-allocate capital when considered necessary from time to time. Similarly, two of our core holdings over the past few years are companies that have been able to radically reinvent themselves recently. The companies in question are Microsoft and Walt Disney (Disney), both household names as well as examples of sustained long-term growth stories.

Microsoft was born with Bill Gates and Paul Allen coming up with the MS-DOS operating system in the 1970s. After early struggles, Mortimer (renamed Mickey) Mouse came to the rescue of Walt Disney's ventures into character animation half a century earlier.

While the essence of both companies has arguably stayed the same over time, their success has very much been a process of evolution in both instances, rather than predestined paths that simply needed to be trod. In the process, they have also built significant war chests to get them through inevitable existential challenges and both businesses have adapted sufficiently to ensure that their services remain consistently in demand in the face of evolving circumstances and tastes over time.

What the two businesses have in common is a change in approach to how products are distributed. In the modern world, subscriptions and targeted advertising have become the sources of revenue being fought for. The holy grail is to establish a direct relationship with consumers in large numbers, providing not only a steady stream of annuity income, but also a self-reinforcing source of information about what people like and don't like.

In the 1990s, for example, Microsoft leveraged its dominant Windows operating system to bundle office software, including email, Internet Explorer (which replaced Netscape), and Office (which replaced WordPerfect, Lotus etc.). More recently, with the shift to cloud computing, many thought that Microsoft could be displaced by the likes of Amazon Web Services and Google.

"Microsoft and Walt Disney have been able to radically reinvent themselves recently"

"What the two businesses have in common is a change in approach to how products are distributed"

We had a different view, however, as we believed that Microsoft was so entrenched in the IT departments of many large enterprises that their collapse was unlikely. And so it has proven: over the past few years, Microsoft has been able to successfully adapt its business model by launching Azure as their cloud infrastructure platform (i.e. a virtual PC) and tacking on its software and databases as a service. Today, Microsoft is second only to Amazon in terms of global cloud revenue (and it is also growing at a much faster clip than its main competitor).

Getting back to Disney: no-one will dispute that this company has terrific content and a great brand globally, but traditionally, it has not had a direct relationship with customers (or their credit card details!). It did, however, have the budget to defend and protect the supply of their proprietary content, as well as the quality of management to respond to a changing environment.

Over the past few decades, cable and satellite content distributors such as Comcast, Charter and Direct TV have created bundles of content for their customers. This forced subscribers to pay for much more content than they consumed: maybe they only wanted sports, or the movie channels, for example, but they were "locked into" a package deal. As these distributors consolidated and grew in scale, their margins grew ever fatter. Some of these distributors (such as Comcast and AT&T) became vertically integrated in the process, which meant that they started buying up content – giving them even more leverage with suppliers.

The transition to streaming has changed the dynamics of the entertainment industry, similar to the transition to cloud computing experienced by Microsoft. To illustrate: in 2011, Netflix had just over 21 million subscribers, but it had none of its own content, and it was thus completely reliant on studios. Today it has around 140 million subscribers – more than any other distributor – and it now makes sense for it to be vertically integrated. Producing its own content, it can offset the fixed costs over a much increased user base. Netflix has become an industry leader, whilst satellite and cable TV are in structural decline (even if their broadband businesses are still doing well).

Relative to Time Warner, NBC, and Universal, Disney does not have a distribution business as such. Whilst Disney does supply content on a non-exclusive basis, it would not be cannibalising itself by launching its own streaming offering – which is exactly what it is now doing. The only thing Disney currently lacks is the direct relationship with the customer (like that of a cable or satellite company). But this was also the starting position of Netflix a decade ago. Disney has the advantage that it can price its quality offering aggressively to acquire customers since its legacy content is already a sunk cost.

In summary, we believe that both **Microsoft and Disney are well placed in an environment that favours companies with direct consumer relationships, global scale and pricing power based on the quality of and demand for their products.** More than most, they should thus be able to continue reinventing growth. ■

Jarrod Cahn - *Director*

Through the looking glass

December 2018 was memorable for so many of the wrong reasons. The festive period between Christmas Day and New Year is normally quiet with thin volumes and low volatility, but not December 2018. By Boxing Day, world equity markets had fallen by some 20% in the space of a few weeks, trade wars between the US and China had escalated, sustainability of corporate earnings were being questioned (Apple had just issued a profit warning), and many believed that this was the beginning of the end of an over-extended bull run in world equity markets.

Looking back, a year later, it is remarkable to see how strongly most equity markets performed in 2019, especially when most pundits had feared the worst.

It is a good time to reflect on where the right decisions were made, where we could have maybe done better, and to continue questioning how we can improve the process and learn from these behaviours.

2019 was a good year for the Credo Global Equity Fund. In USD terms we returned 32%, outperforming our stated benchmark (The MSCI World Index) by 4%. What is more pleasing, is that we managed to achieve this during a continued period of underperformance for value strategies (during the same period the MSCI Value Index underperformed the MSCI Growth Index by around 12%, returning only 17%). This would indicate that the outperformance came in the form of some successful stock-picking. Market volatility gave us the opportunity to buy some quality companies that had fallen out of favour either due to trade war concerns, political and regulatory issues or temporary earnings misses.

Let us start with Apple. Between October 2018 and December 2018, Apple's share price had fallen from $225 to $150 on concerns that the trade war between China and the USA was having a significant impact on sales of its products in China. Apple is a stock we have owned on and off over the years, and at $150 we believed that the valuation of the business looked very compelling and so we bought back into it. During this period, we also managed to buy other good quality technology names that had previously screened too expensively, e.g. Facebook, which was still suffering from a fallout from the Cambridge Analytica scandal as well as a general sell-off in technology names.

During the course of 2019, we also got the opportunity to buy some stocks that were hit by what we considered to be an overaction to news-flow. Bayer is a good example: having acquired Monsanto during 2018, the company announced that Monsanto was subject to legal action from a number of plaintiffs claiming that its "Roundup" product was carcinogenic. On the back of these legal claims, the stock price retreated rapidly, wiping out €50 billion of its market capitalisation based on what we considered to be a maximum liability of €8bn-€10bn (which would further only be payable over an extended period). On that basis we bought the stock. It has performed well since, rising from €55 to €75 over the year. Although there has been no settlement to date, it is rumoured that Bayer is due to settle for around €10bn imminently.

Some other purchases in our portfolio have been stocks that were driven by corporate action or restructuring, for example Frontdoor, which was in fact our best performing stock for 2019. This is a company that was spun out of Servicemaster towards the end of 2018. We sold our holding in Servicemaster and switched to Frontdoor towards the end of 2018; Frontdoor more than doubled during 2019.

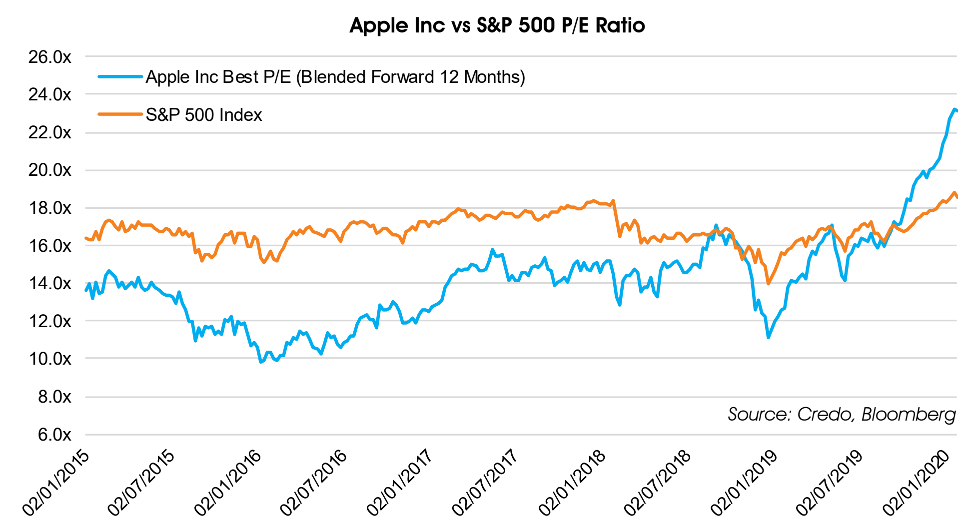
We also acquired a position in Madison Square Gardens, which announced the splitting of its business into two separate listings: SportsCo and EntertainmentCo. Our entry point was opportunistic, as the stock had fallen on news that the spin-off would be delayed and that the costs of developing its Sphere project in Las Vegas would be over budget. We still see significant value in the sum of the parts of the business, and we remain patient investors as the restructuring nears fruition.

We also saw one of our stocks acquired in 2019: Merlin Entertainments was bid for by a consortium including Kirkbi (the Lego family office) and the Blackstone Group.

Clearly, one always makes mistakes in investments and possibly our biggest mistake was selling our holding in Apple too early, given how well the stock has continued to do. We have since revisited the trade to see if there were lessons to learn, and to be honest, based on our investment methodology, if we had the same scenario again, we would probably have acted in exactly the same way. When we initiated a position in Apple in January 2019, the stock had suffered a significant fall in price and the P/E ratio had dropped back to 12.7x, which we believed to be too cheap. By April, the stock had re-rated back to 16x, a similar level to where it had peaked in the previous year, and the highest level that it had traded at in its previous five-year history.

Interestingly, over the previous five years, Apple had never traded at a premium or even equal rating to the S&P 500 Index. Subsequent to selling the stock, it has been a stellar performer but practically all of that performance has come from a significant re-rating of the stock, as it has broken well above its previous valuation range relative to the S&P 500, and now trades at a hefty premium multiple of close to 23x.

If one were to analyse the potential earnings growth of Apple, there seems to be a significant disconnect between the re-rating and earnings growth. Bloomberg analysts are forecasting earnings growth of around 13% per annum for the next two years, but a significant portion of that is actually driven by share buy-backs. The underlying business appears to be growing at single digit increments.



Source: Credo, Bloomberg

In summary, 2019 was a good year for the Credo Global Equity Fund as well as other Credo related equity products. As we look forward to 2020, one is always wary that it is difficult to find good returns when the market has had such a strong run in the previous year. However, one should also point out that not all markets performed equally well: UK and Europe were again laggards, as they continued to suffer from a political and economic overhang.

At the time of writing this article, Asia is being affected by the coronavirus, of which the extent and consequences are too early to quantify. What we do know is that events like this lead to volatility in the markets, and volatility leads to the opportunity to buy mispriced assets.

We have no control over the movements of world markets, but all we can continue to do is apply our investment philosophy and discipline, looking to firstly preserve capital for clients, and then to provide them with a long-term steady return on their investments. ■

Andrew Cormack - *Business Development Manager, Investment Solutions*

Credo expands its SA presence with Global Equity Feeder Fund

Over the past few years, several clients have indicated a desire to gain international investment exposure through Credo from a base within South Africa (SA). There are several reasons why SA investors may wish to do this. Many clients retain a foothold within the country, and with that comes local liabilities to service. It could also be that there are extended family members or other financial obligations that require funding in rands (ZAR); having investments that generate income locally makes this process easier. Separately, the South African Reserve Bank implements exchange controls and there may be some pools of capital which cannot easily leave the country.

In June 2017, we launched the Credo Global Equity Fund: a dollar/pound denominated unit trust, UCITS-regulated and based in Ireland, which invests across global, developed equity markets. **In response to the local SA interest, we followed this up by launching the BCI Credo Global Equity Feeder Fund ("Feeder Fund") on the 3rd of February 2020: a ZAR-denominated, South African-regulated unit trust, the sole purpose of which is to provide access to the Credo Global Equity Fund for local South African investors.**

For those unfamiliar with feeder funds, South African law permits the creation of local vehicles that invest in foreign unit trusts. In this sense, they are conceptually similar to secondary stock listings or American Depository Receipts: instruments which allow investors to access a "foreign" investment from within their own domestic jurisdiction. In the case of the Feeder Fund, its sole investment will be in the Credo Global Equity Fund.

In order to remain competitive, Credo has priced the Feeder Fund to bring it in line as much as possible with the underlying Credo Global Equity Fund. The Total Expense Ratio (TER) is expected to be comparatively low when set against other feeder funds available to the South African market.

Investors can invest directly via Credo's local management company partner, BCI, or via a number of SA investment platforms.

As a start, the Feeder Fund will be available on both the Momentum Wealth and Glacier platforms, with more set to come online across 2020.

All ZAR investments into the Feeder Fund are converted into USD when sent to the Credo Global Equity Fund. Any disbursements or redemptions to Feeder Fund investors will be in ZAR. Performance in the Feeder Fund will therefore mirror the underlying Credo Global Equity Fund, plus/minus exchange rate movements (and any differences in fees).

The minimum investment amount is low (determined by the relevant platform) and investors are permitted to make lump-sum payments or regular monthly debit orders. This means that the Feeder Fund is an ideal investment opportunity for anyone, be it a high net worth individual, an amateur investor or as part of a financial advisor's arsenal of investments.

These benefits can be summarised as follows:

- **Access to a diversified, offshore equity investment product**
- **The underlying fund is authorised and regulated by the Central Bank of Ireland as a UCITS**
- **Invest using South African rands – no need to send money offshore or incur currency exchange costs**
- **No requirement to apply for approval for foreign exchange transfers**
- **Credo will seed the Feeder Fund with a significant amount of capital on day one, helping to reduce costs**
- **Invest either by monthly debit order or via a lump sum, with very accessible minimums**
- **Already available on leading South African investment platforms such as Momentum Wealth and Glacier**
- **Provides an investment whose performance is uncorrelated to the South African economy**
- **The Feeder Fund is highly liquid with daily pricing and no restrictions on redemptions / withdrawals**
- **Strong support from Boutique Collective Investments (RF) (Pty) Ltd, a leading administrative services provider in South Africa**
- **Investors will benefit from the focussed and expert management of the Credo investment team in London**
- **Attractive for smaller investors or start-up savers**

There is no intention to follow up this launch with other domestic South African products. Credo's core identity has always been that of an international wealth manager. Our fund and portfolio range reflect that, with no particular focus on single-geography products.

In that light, the Feeder Fund is not a "South African" fund, but rather an additional channel for investors to access the Credo Global Equity Fund.

For additional information, please contact Credo directly, speak with our partner, Boutique Collective Investments, discuss with your financial advisor or ask your chosen investment platform. ■

Kathryn Linde - *Relationship Manager*

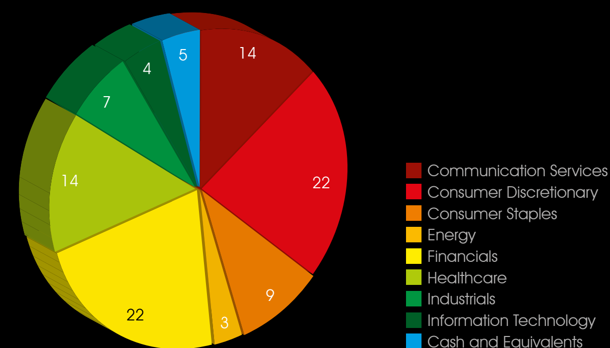
The Credo Funds

GLOBAL EQUITY FUND

Credo 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 Credo Global Equity 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 (%)



Communication Services
Consumer Discretionary
Consumer Staples
Energy
Financials
Healthcare
Industrials
Information Technology
Cash and Equivalents

Currency Allocation (%)

GBP	21.0
USD	68.0
Other (AUD, HKD, SGD, EUR, MXN)	11.0

Past Performance (%)

	Fund	Benchmark
1 Month*	2.4	0.4
3 Months*	5.4	0.6
1 Year*	27.0	22.7
S. Inception *(Cumulative)*	22.9	25.7
S. Inception *(Annualised)*	8.6	9.6

Inception: 03/07/2017.
Highest: 6.0% (Jun), lowest: -2.8% (Aug).
Benchmark: MSCI World Index Net Total Return.

Top 10 Holdings (%)

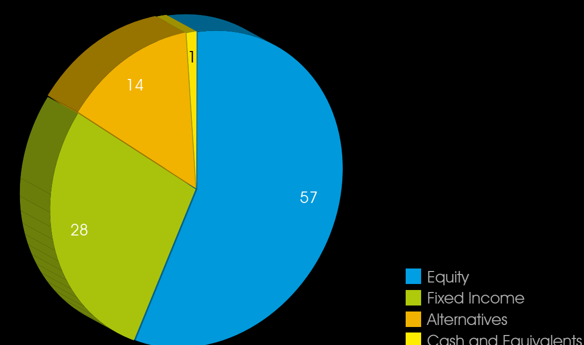
Alibaba Group Holding Ltd	Consumer Discretionary	4.3
Microsoft Corp	Information Technology	4.2
HCA Healthcare Inc	Health Care	4.0
Adtalem Global Education Inc	Consumer Discretionary	3.9
Prudential plc	Financials	3.8
Cigna Corp	Health Care	3.8
Arch Capital Group Ltd	Financials	3.8
Wells Fargo & Co	Financials	3.5
Sberbank Of Russia PJSC	Financials	3.4
The Walt Disney Company	Communication Services	3.4

DYNAMIC FUND

Credo Dynamic Fund

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 Credo Dynamic Fund has flexibility to invest across asset classes depending on prevailing market conditions.

Asset Allocation (%)



Equity
Fixed Income
Alternatives
Cash and Equivalents

Currency Allocation (%)

GBP	92.0
USD	8.0

Past Performance (%)

	Fund	Benchmark
1 Month*	2.4	1.9
3 Months*	4.3	2.8
1 Year*	15.5	15.7
S. Inception *(Cumulative)*	16.7	13.3
S. Inception *(Annualised)*	6.4	5.1

Inception: 03/07/2017.
Highest: 4.1% (Apr), lowest: -2.1% (Aug).
Benchmark: IA Flexible Investment Sector.

Top 10 Holdings (%)

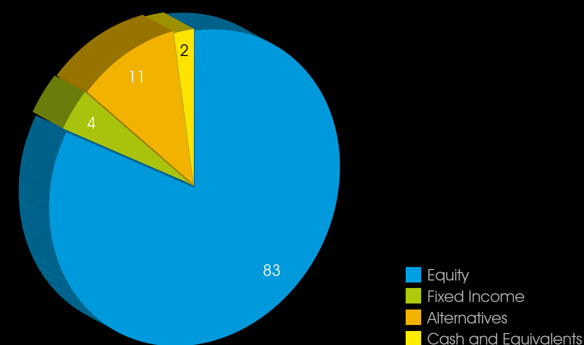
SPDR MSCI World UCITS ETF	Exchange Traded Product	5.3
Vanguard FTSE 250 UCITS ETF	Exchange Traded Product	4.6
AQR Global Defensive	Open-End Fund	4.1
Co-operative Group Ltd 11 12/18/25	Corporate Bond	3.4
X-trackers MSCI World UCITS ETF	Exchange Traded Product	2.5
Crystal Amber Fund Ltd	Closed-End Fund	2.3
iShares Core S&P 500 UCITS ETF	Exchange Traded Product	2.2
Hipgnosis Songs Fund Ltd	Closed-End Fund	2.0
Mercia Asset Management plc	Financials	1.9
PPHE Hotel Group Ltd	Consumer Discretionary	1.9

GROWTH FUND

Credo Growth Fund

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 Credo Growth Fund aims to provide attractive risk-adjusted returns and also has the flexibility to invest across asset classes.

Asset Allocation (%)



Equity
Fixed Income
Alternatives
Cash and Equivalents

Currency Allocation (%)

GBP	55.0
USD	42.0
Other (HKD, EUR, ZAR)	3.0

Past Performance (%)

	Fund	Benchmark
1 Month*	1.1	1.9
3 Months*	4.7	2.7
1 Year*	20.7	15.7
S. Inception *(Cumulative)*	15.3	13.3
S. Inception *(Annualised)*	5.9	5.1

Inception: 03/07/2017.
Highest: 5.9% (Apr), lowest: -3.7% (Aug).
Benchmark: IA Flexible Investment Sector.

Top 10 Holdings (%)

Alibaba Group Holding Ltd	Consumer Discretionary	4.5
Costco Wholesale Corp	Consumer Staples	4.5
Microsoft Corp	Information Technology	4.4
Intermediate Capital Group plc	Financials	4.3
Primary Health Properties plc	Real Estate	3.3
Alphabet Inc	Communication Services	3.0
Berkshire Hathaway Inc	Financials	3.0
Amazon.com Inc	Consumer Discretionary	2.9
PayPal Holdings Inc	Information Technology	2.6
JD Sports Fashion plc	Consumer Discretionary	2.6

(*) Actual performance. Source: Société Générale Securities Services (Ireland) Limited. As at 31/12/2019. Performance is of the Class A GBP Retail share classes and is measured using NAV to NAV dates, net of fees and with income reinvested. Individual investor performance may differ as a result of initial fees (if any), the actual investment date, the date of reinvestment and dividend withholding tax. Annualised performance shows longer term performance rescaled to a 1-year period. Annualised performance is the average return per year over the period. Actual annual figures are available to the investor on request. A schedule of fees, charges and maximum commissions are available upon request. There is no guarantee in respect of capital or returns in a portfolio. Credo Growth Fund is currently subject to a performance fee. Full performance calculations are available from the manager on request. For any additional information such as MDDs, prospectus and supplements please go to www.credogroup.com.

Ainsley To - *Head of Multi-Asset*

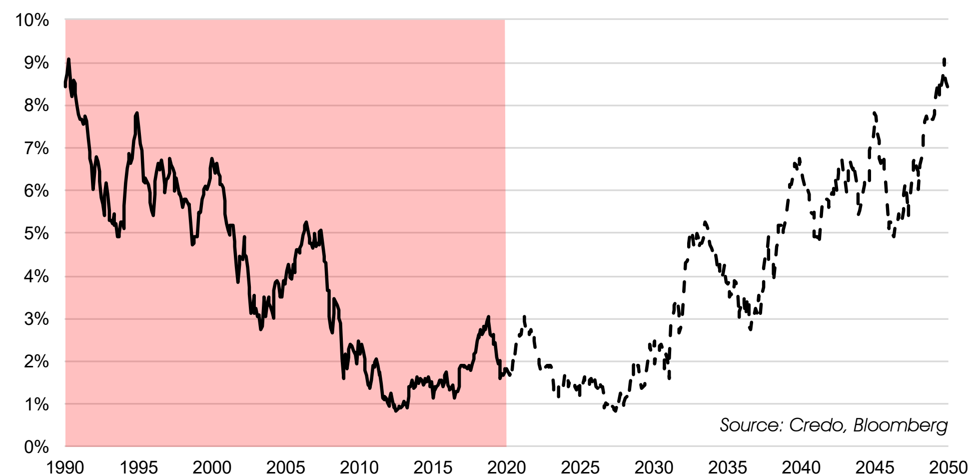
Back to the future 2050

"You guys aren't ready for this yet. But your kids are going to love it."
Marty McFly

World interest rates were closer to 10% than to zero in 1985, the year Marty McFly needed to return to after travelling back in time by 30 years in the original Spielberg classic. The persistence of very low nominal interest rates and bond yields (in many cases near zero) have on the other hand characterised the 2010s and these are still with us going into a new decade. In the context of long-term history (the Bank of England documents world interest rates over the last eight centuries, for example), we would suggest that the current environment appears to be somewhat of an outlier.

This is not news to the investment community: the spectre of rising interest rates has been a perpetual concern for policymakers and investors alike for the best part of a decade. Whilst it is not our investment philosophy to forecast interest rates or other variables, we thought it would be interesting to run the following thought experiment as we stand at the beginning of a new decade: What if bond yields spent the next 30 years reversing their path, ending in 2050 where they were in 1990? In other words, what if we experienced the exact mirror image of the red area in Chart 1? And given this (admittedly extreme) scenario, what would be the experience for bond investors over the period?

Chart 1: "What if bond yields reverse to where they were 30 years ago?"



Into the DeLorean

In the world of bonds, there is a mathematical relationship between the yield and the return (a fall in yield equates to a rise in price, and vice versa), which means any forecast of rising yields is a pessimistic forecast for bond prices.

However, an important consideration is that the Credo Multi-Asset Portfolios (MAP) invest in portfolios of bonds, not individual bonds with fixed maturities. These portfolios are "ladders" (staggered across a variety of maturities), reinvesting both coupons as they are paid as well as principal as bonds mature into newer bonds. This is significant, as the reinvestment is made at the prevailing level of bond yields - so **if rates were to rise, a portion of such a bond portfolio would be continuously "resetting" to the higher interest rate.**

Chart 2 breaks down the return from a broad US government bond index into the Income Return (blue), which has always been positive, and the Price Return (red), which fluctuates depending on interest rate moves. Were yields to precisely reverse their path from now until 2050, the income return would be identical as compared to the past 30 years (simply in reverse order). The difference would come from the price returns, which would be the negative of what they were between 1990-2020 e.g. capital losses where they were previously capital gains (and vice versa).

Great Scott! **Chart 3 shows that, over the past 30 years, the vast majority of bond returns was due to the income component**, whilst the overall positive return from price changes has been a much smaller consideration for long-term investors (the small difference in the absolute number for the actual price returns in a falling rate environment versus the reverse is due to compounding).

As seen in Table 1, whilst the 4% annualised one might earn from now to 2050 (assuming bonds retraced their history precisely) is less than the 5.6% over the past 30 years, it is hardly what one would describe as a pessimistic forecast for fixed income securities. From a risk perspective, the volatility over the next 30 years would be almost exactly the same, with a marginally worse maximum drawdown and mildly fewer positive months than over the past three decades (61% of months vs 64%).

Even in this extreme scenario for bond yields, the end result over the whole period is not drastically different for a bond portfolio: in fact, returns and risk are similar on the whole (and certainly far from an extinction level event as described by many bond bears).

Even though the short-term journey, which is driven by price moves, would involve many ups and downs (as would be the expectation with most risky assets), most investors with a reasonable time horizon would still experience a positive annualised return in this hypothetical future, as most of the noisy price moves cancel each other out and the overall return is largely driven by the income component.

Conclusion

With a new decade comes new temptations to make some investing forecasts. But as anyone who follows MAP would know by now, our philosophy is to design portfolios with minimal reliance on being able to predict the future. We believe in diversifying across a number of asset classes and strategies, including bonds, which – despite the low yields of the past decade – are still a useful tool to include in the toolbox of a diversified investor in our opinion.

This thought experiment should not be seen as a bull case for government bonds, neither does it suggest that bonds are without risk or serve as a prediction of what is likely or unlikely to happen going forward. We are merely trying to illustrate that simply invoking the long-term history of interest rates, is not alone a reason to avoid bonds: even the extreme scenario in which bond yields fully reverse, it does not imply a bond apocalypse. To successfully base an investment strategy on a forecasting framework, one would need to make accurate predictions about the behaviour of bond investors, issuers, policymakers as well as the many other factors that move bond prices… **and to get the direction and timing correct on all those predictions, you really would need a time machine!**

Table 1

%	Actual (1990-2019)	If Reversed (2020-2050)
Return *(annualised)*	5.6	4.0
Volatility *(annualised)*	4.4	4.3
Max Drawdown	-5.4	-7.5
% of months positive	64.3	61.0

Source: Credo, Bloomberg

Chart 2: Bond Returns If Yields Reverse Over 30 years - Price vs Income

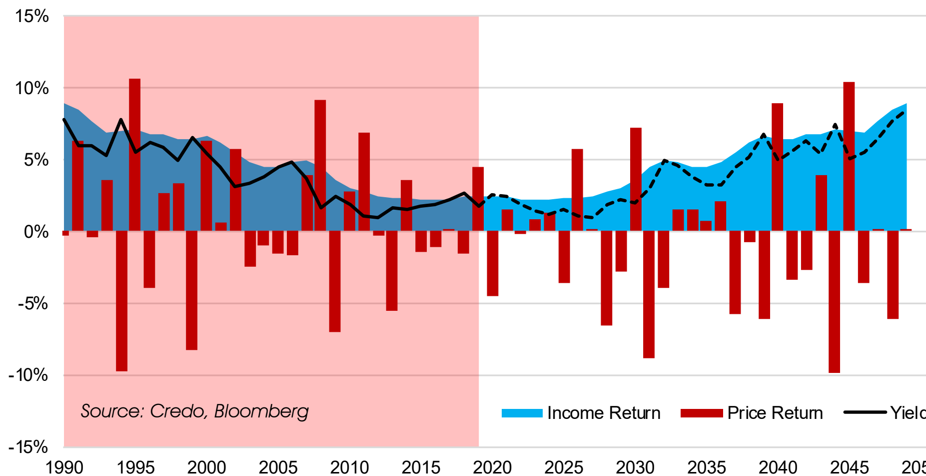
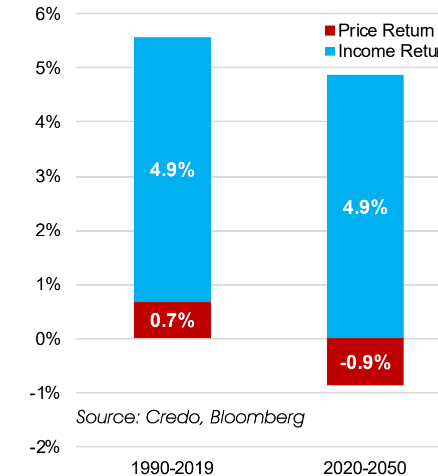


Chart 3: 30 Year Returns by Income and Price



Calvin McLean - *Investment Analyst*

Should I trim my hedge for FX sake?

The question of currency hedging is one that the Multi-Asset Portfolio (MAP) team at Credo has been asked many times over the past few years, specifically in the context of clients' exposure to sterling at a time of pound volatility.

Unfortunately, the "perfect" answer does not exist, as nobody knows the future path of exchange rates. This piece will attempt to provide some clarity on the MAP perspective to currency exposure, namely a preference for a long-term, evidence-based approach that doesn't require perpetual half-baked "tactical" tinkering.

Approaching it in this manner has led us to favour, at present, the hedging of currency for bonds but not for equities (subject to other fund selection considerations). Importantly, this decision was not driven purely by past performance (despite observing that currency hedging had a worse impact on return for equities than bonds over the sample period); but instead by the interaction of currency with the asset class itself and how this can produce very different risk outcomes.

To begin with, some summary statistics from broad asset class indices (January 2002 – January 2020) are included in the following table:

	Global Equities *(%)*		Global Bonds *(%)*	
	GBP Unhedged	GBP Hedged	GBP Unhedged	GBP Hedged
Return *(annualised)*	7.4	6.6	5.3	5.0
Volatility *(annualised)*	15.6	15.3	8.3	2.5
Max Drawdown	38.1	54.8	14.9	3.8

Source: Credo, Bloomberg

Notice that during the period in question, **there has been a disconnect between the volatility reduction achieved through currency hedging in bonds compared to that in equities**.

Principally, this is due to the relative volatility of the foreign currency (typically around 10%) versus the asset class (represented by the hedged investments in the table, i.e. 2.5% for bonds and 15.3% for equity). In the case of bonds, the volatility of the currency so far exceeds that of the asset class that the risk characteristics of the unhedged investment looks more like that of currency than bonds. Equity on the other hand has a higher volatility than currency, leading to potential for foreign currency exposure to provide useful diversification.

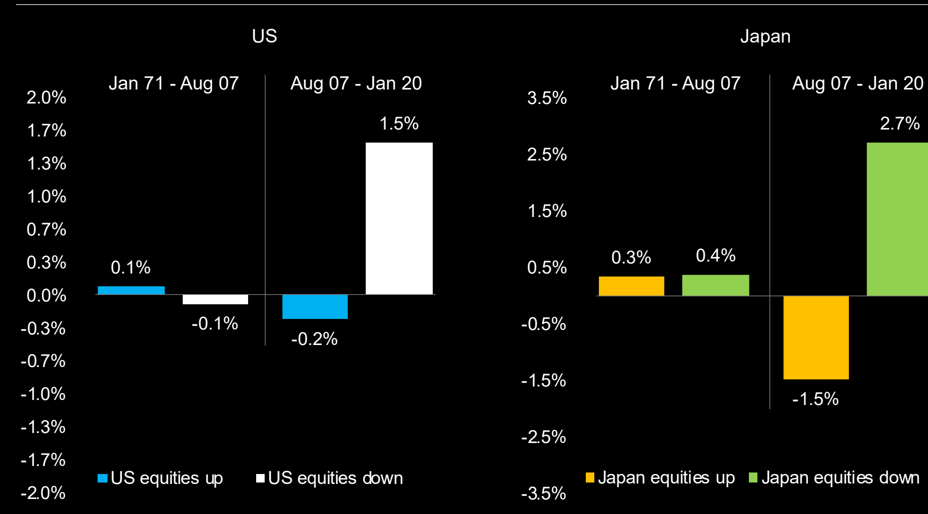
In interpreting this potential, we need to understand the relationship between currency and equity in a global equity portfolio, which if represented by correlation is a country-weighted average between the underlying equity markets and their respective currencies (measured in sterling). All this means is that, for example, a negative correlation would imply that a decline (increase) in global stocks will, on average, be associated with a currency gain (loss) for a sterling portfolio.

An analysis of the historical correlation (back to 1971) exposes two distinct periods – before and after the Global Financial Crisis (GFC). Before the GFC foreign currency had zero correlation with equity for a sterling investor, however since mid-2007 the correlation has been closer to -0.3. This is because sterling's profile now resembles one that's more typical of a risky currency, while the US dollar and Japanese yen have become more pronounced "safe haven" currencies.

This shift has meant that sterling investors now benefit from exposure to these currencies (which make up 70% of Global Equities). The extent of this benefit becomes clear when we investigate the distribution of monthly currency returns before and after the GFC (chart below): while previously the average currency return was near zero, since 2007 when US or Japanese stocks have fallen, the dollar and the yen have on average strengthened against the pound (and vice versa). Additionally, the average currency gain when equities are down, has been significantly larger than the average currency loss when equities are up. This asymmetry has provided some "downside protection", explaining why hedging, a strategy which normally implies risk mitigation, has seen a much larger maximum drawdown than its unhedged equivalent (54.8% vs 38.1% in the table).

How would our equity allocation be affected if the correlation returns to its historical average?
In that case, the safe haven benefits would disappear (as seen in the chart from January 71 – August 07), and the unhedged investment volatility would increase around 3% - a tolerable increase in the context of total equity market volatility.

Average monthly currency return for sterling investor



Source: Credo, Bloomberg

In addition to the arguments surrounding risk, another factor to consider when hedging currency exposure is cost (an important consideration for all MAP investments). Two current examples include higher explicit ETF expenses and the forgone return from hedging higher interest rate currencies (which arises because the instruments used for hedging are priced such that it is equivalent to borrowing the foreign currency and lending in the domestic currency).

In conclusion, the Credo Multi-Asset Portfolios don't rely on short term forecasts of the future direction of currencies. We instead view currency exposure from a risk perspective, weighing the costs of hedging with potential benefits of diversification. Therefore, when asked about political events in the UK and the potential for a large appreciation in sterling (bearing in mind that a depreciation will always favour not hedging), I can't help but be reminded of the famous line by Benjamin Graham

"In the financial markets, hindsight is forever 20/20, but foresight is legally blind". ■

Jack Carbutt - *Relationship Manager*

Diversified equity portfolios

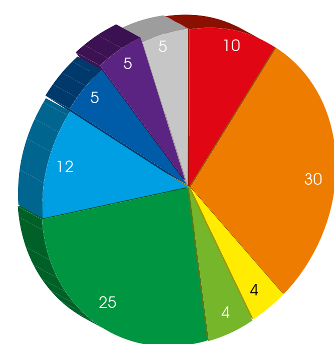
The Best Ideas and Dividend Growth portfolios are diversified global equity portfolios, which we believe to be well positioned to outperform the wider equity market over the longer term. The portfolios have biases towards developed-market, large-capitalisation stocks.

BEST IDEAS PORTFOLIO

Performance (%)

Return	
YTD	23.7
1 Month	1.2
3 Months	3.9
1 Year	23.7
Annualised Return	
3 Years	11.3
5 Years	13.4
Since Inception	12.6

Sector Allocation (%)

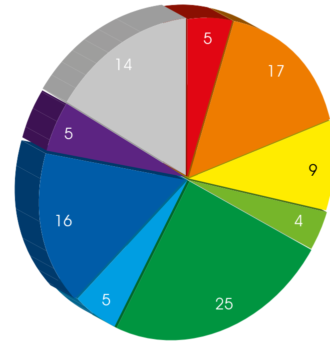


DIVIDEND GROWTH PORTFOLIO

Performance (%)

Return	
YTD	22.9
1 Month	1.3
3 Months	2.9
1 Year	22.9
Annualised Return	
3 Years	8.8
5 Years	13.9
Since Inception	14.0

Sector Allocation (%)



Value orientated investment philosophy

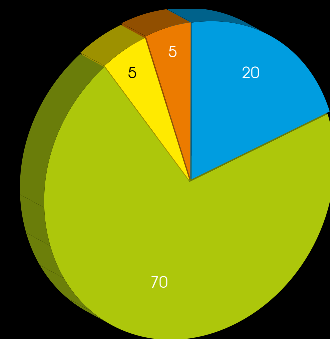
The Credo Multi-Asset Portfolios (MAP) follow an evidence based approach to investing, providing investors with diversified exposure to global assets through a selection of funds and ETFs. Funds are selected using Credo's in-house selection process and offered as four solutions targeting various levels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

MULTI-ASSET PORTFOLIO 20/80

Performance (%)

Return	
YTD	8.8
1 Month	0.1
3 Months	-0.8
1 Year	8.8
Annualised Return	
3 Years	4.7
Since Inception	6.0

Strategic Asset Allocation (%)

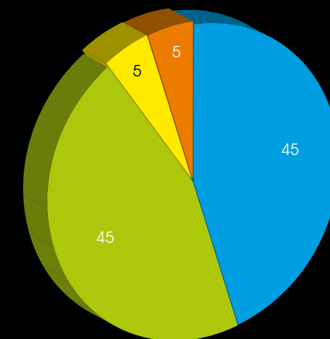


MULTI-ASSET PORTFOLIO 45/55

Performance (%)

Return	
YTD	12.4
1 Month	0.4
3 Months	-0.4
1 Year	12.4
Annualised Return	
3 Years	5.9
Since Inception	7.5

Strategic Asset Allocation (%)

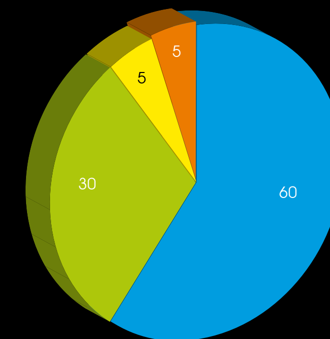


MULTI-ASSET PORTFOLIO 60/40

Performance (%)

Return	
YTD	14.6
1 Month	0.6
3 Months	-0.1
1 Year	14.6
Annualised Return	
3 Years	6.7
Since Inception	8.5

Strategic Asset Allocation (%)

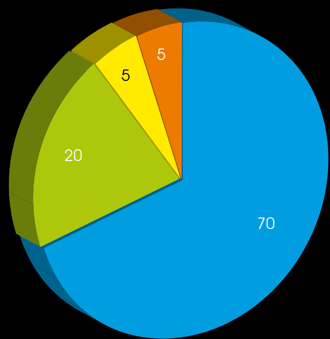


MULTI-ASSET PORTFOLIO 70/30

Performance (%)

Return	
YTD	16.0
1 Month	0.7
3 Months	0.1
1 Year	16.0
Annualised Return	
3 Years	7.1
Since Inception	9.0

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 net dividends, reinvested. Following additions or removals, each holding is rebalanced to the model weighting. Source: Bloomberg pricing as of 31/12/2019 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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