

The power of networks



Quarterly Letter

Issue 28 | October 2020



Foreword

I hope you and your loved ones remain safe and well, and that you managed to get some sort of break over the summer.

A lot of commentators have discussed how the current pandemic has accelerated an array of pre-existing trends ranging from online shopping to remote working and sustainable investing. I would argue it has also served as a powerful reminder of many things we took for granted, including the importance of networks, whether with our family, friends or colleagues.

In my work life I miss how easy it was to ask a quick question of a colleague, pull a group together to discuss a particular challenge and also for us to train new hires. Like many firms we have embraced technology and were fortunate to have had a bit of a head start. In seeking to cut our carbon footprint we had already begun to embrace virtual meetings; we held several remote working days as part of our contingency planning; and sent most of our staff home several weeks before lockdown.

However, just as connecting with our children and parents online is no replacement for seeing them in person, the business collaboration and sense of team can't (currently) be fully replicated virtually. That said, with a strong culture and the power of technology we have been able to quickly replicate our network, both internal and external.

In this Quarterly Letter we explore the importance of networks, how our firm has grown strong through them and how we use them today to enhance our investment approach.

I believe our network is powerful – and it is stronger for having you as our clients. The insights we receive from many of the most successful entrepreneurs and businesspeople make us better investors. We are also extremely grateful to the many happy clients who have recommended us to their family, friends and colleagues. We hope we have continued to meet the high expectations you set and thank you for your continued support.



Helen Watson
CEO, Rothschild & Co Wealth Management UK



Cover image:
Envelope from a Presidential
'Thank you' sent to Nathaniel 1st
Lord Rothschild (1840–1915),
Senior Partner N M Rothschild &
Sons, from President Theodore
Roosevelt (1858–1919)
in 1904. Courtesy of The
Rothschild Archive.

Rothschild & Co Wealth Management
New Court
St. Swithin's Lane
London
EC4N 8AL
+44 20 7280 5000
rothschildandco.com

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Publication date: October 2020.
Values: all data as at 25th September 2020.

The power of networks

History's great inventors rarely worked alone. Look behind their scenes and you'll discover a hidden team of confidantes, colleagues and loved ones who helped

Albert Einstein developed the theory of relativity. Alexander Fleming discovered penicillin. Florence Nightingale founded modern nursing.

They were lone geniuses whose individual brilliance led to ground-breaking advances in their respective fields. Or so the history books tell us. The truth, as always, is a bit more complicated.

Einstein struggled with his theory for years until he got his old classmate Michele Besso a job at the same patent office where he worked. They regularly discussed physics on their daily commute. After a particularly fruitful chat, an epiphany about time and space “suddenly dawned” on Einstein¹, and so $E=MC^2$ was born.

Behind every great inventor or genius, there is often a powerful network of collaborators, confidantes, colleagues and loved ones who helped them get there.

Fleming did indeed discover penicillin (albeit accidentally) after a petri dish of bacteria he had left while he went on holiday began festering with antibiotic mould. But Fleming was never able to produce a viable medicine and eventually abandoned his work. It took a whole team of Oxford University scientists to work out how to purify penicillin and turn it into the wonder drug we know today.

And while Nightingale undeniably revolutionised nursing with her progressive views on hospital hygiene and public sanitation, she rarely worked alone. ‘The Lady with the Lamp’ came from a well-connected, wealthy family, and her life-long friendships with influential figures of Victorian England – including Queen Victoria herself – gave her the support she needed to achieve her ambitious social reforms.

Many pivotal inventions and discoveries throughout history are popularly attributed to a single person. But behind every great inventor or genius, there is often a powerful network of collaborators, confidantes, colleagues and loved ones who helped them get there.

Success in business or investing is no different. At Rothschild & Co, we don't pretend to know everything. There will always be opportunities that lie beyond our direct expertise or available resources.

This is where our professional networks help us to paint a more accurate picture of the investment landscape. They add the fine brushstrokes that bring our portrait of a company or market to life.

First, let's talk about why networks matter.

Debunking the lone genius myth

Great networks come with a lot of benefits. Collaboration often leads to more creativity, faster innovation and better market access.²

Yet the myth of the lone genius is an enduring one. That's partly because we romanticise how innovation occurs. We like to imagine a reclusive prodigy, tinkering away in a makeshift workshop, shouting “Eureka!” as they finally make the big breakthrough that will change the world.

It's a nice image, but as we've seen, this wasn't often the case in the past, and it's even less true now. Back in 1900, nearly nine out of every 10 scientific papers published in journals were authored by individuals. This figure had plummeted to just 7% by 2011.³

The days of the solo inventor, if they ever really existed, are fading.

We shouldn't necessarily see this as a bad thing. Technological advances and globalisation have made it much easier for great minds to swap ideas, share data and work together, wherever they are in the world.

The scientific community is now better connected than ever before, pushing the boundaries of our knowledge and leading to breakthroughs that would never have previously seemed possible.

¹ Einstein and Besso: From Zürich to Milano

² How Do Networks Matter? The Performance Effects of Interorganizational Networks

³ Team size matters: Collaboration and scientific impact since 1900



The hidden particle

Bosons are named after Satyendra Nath Bose, an Indian mathematician and physicist who theorised how these particles behave.

Major academic journals initially rejected his early work. Fortunately, he had an ace up his sleeve: Albert Einstein. Bose had helped translate Einstein's theory of relativity into English, and he sent a letter to the physicist asking for his help.⁴

Einstein vouched for Bose's work and even helped him develop it, leading to further collaborations between the two. Despite Bose's obvious talent and intellect, his theories may never have seen the light of day without a powerful network to rely on.

The discovery of the Higgs boson particle is a good example. Peter Higgs was one of six scientists who developed theories in 1964 to explain how some particles acquire mass. Working independently across three teams, the researchers proposed the existence of an elementary particle, the Higgs boson, but they couldn't prove it. The technology simply wasn't there yet.

Fast-forward to 2012, and experiments at CERN's Large Hadron Collider had finally observed the elusive particle in action.

Three years later, scientists and engineers published a research paper aimed at precisely estimating the size of the Higgs boson. The number of authors? 5,154. Only the first nine pages of the 33-page article are about the research – the rest of the document simply lists the many, many contributors.⁵

Theorising the existence of the Higgs boson took just a handful of people. Measuring the size of the particle required thousands.

What lessons can we learn from this? It's difficult for just one person, team or organisation to have the breadth and depth of knowledge needed to find the right answers to every question.

We live in a complex world where better collaboration isn't just possible, it's essential.

That's something we've always understood at Rothschild & Co. It's why, throughout our history,

we've established and nurtured a strong network of trusted agents and partners. We'd like to take some time now to explain that network's origins.

The beginnings of a global network

Like the discovery of the Higgs boson particle, the story of the Rothschild family's success can be traced back to six key figures – Mayer Amschel Rothschild and his five sons, Amschel, Salomon, Nathan, Carl and James.

Mayer Amschel had built a reputation for truth and honesty among his clients over an illustrious career of trading in coins, medals and other, mainly British, goods. It was Mayer's interest in England's bustling cloth trade that would encourage him to send his third son, Nathan, to Manchester to set up the first overseas Rothchild branch in 1798.

Nathan later moved to London and established himself at New Court in 1809, building the business that became NM Rothschild & Sons. We are proud to say that New Court remains the UK headquarters of Rothschild & Co to this day, more than 200 years later.

The Rothschilds' already expansive network really began to flourish from 1820 onwards. By this time, four of the five brothers had set up banking branches across key European cities. Nathan was in London, James in Paris, Carl in Naples and Salomon in Vienna. The eldest, Amschel, remained in Germany and had taken over the Frankfurt bank when his father died.

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From kings and queens to emperors, generals and popes, they developed a diverse network of connections in high places. Information was just as key to financial decision-making then as it is now and access to the latest political intelligence allowed the brothers to stay ahead of market movements.

They also had commercial relationships with trusted agents and partners across Europe, such as the leading Bleichröders business in Berlin, and assisted in the establishment of the Weisweillers in Madrid.

⁴ *Physics Today: The man behind Bose statistics*

⁵ *Physics paper sets record with more than 5,000 authors*

The network had already spread far beyond Europe, however. In Latin America, the family had agents in Valparaiso, Havana and Rio. They also forged ties with Jardine, Matheson & Co in 1838, when it was one of the few British businesses to have roots in Asia.

The Rothschilds ran businesses that were truly global at a time when globalisation was largely unheard of.

The importance of the family's expansive network during this time can't be overstated, according to Rainer Liedtke, a professor of European history at the University of Regensburg.

"Overall, it seems that not only the diversity, but the sheer size of the network ... should be regarded as a prime reason for [the Rothschilds'] extreme success," he said.⁶

It's a statement we're confident still holds true today.

Building better relationships

The world has changed a lot in the years since Nathan and his brothers flew the proverbial nest and settled into their new homes across Europe.

Rothschild & Co has also changed, although many of our values remain the same, including our commitment to maintaining strong relationships with the people in our network. It's a principle that not only applies to the many agents we have around the world, but also the companies we invest in.

Good investment research is about continuous learning. Our teams scour trade journals, read companies' annual reports and track the latest macroeconomic trends, of course.

But people are central to the success of any business, so to really understand how a company operates, you have to understand its people. Words on a page can only tell you so much. Would you hire someone on the strength of their CV alone, for example?

Reconnecting with old friends

In 2005, nearly 170 years after first establishing a partnership, the Rothschilds and Jardine, Matheson & Co renewed their historic relationship. Jardine, which is also a family-owned firm, bought a minority shareholding in Rothschilds Continuation Holdings.

We often emphasise that our investment outlook is over the long term. It's safe to say we take the same approach to maintaining close relationships within our network; not just over decades, but centuries.



Our network in action: unearthing common ground

We've talked a great deal about pioneers and innovators in this quarterly letter. We'd like to add one more name to the list: John Deere.

When Deere first opened a shop in Illinois selling pitchforks and shovels in 1837, farming was a far cry from the precision agriculture we see today. Back then, there were no drones, satellites or robots to help farmers manage their fields all the way down to a single crop.

No, this was a time of one farmer and a horse. A time when tilling the fields manually was a gruelling, unforgiving task.

A blacksmith by trade, Deere was able to lift some of this burden by inventing a steel plough, which didn't have to be cleaned as regularly as traditional iron or wooden ploughs.⁷ News of his revolutionary product spread quickly, establishing Deere & Co as an industry innovator; a reputation it continues to hold more than 180 years later.

We know the people at John Deere extremely well, and our relationship goes from strength to strength every year.

It helps that our companies are so alike. We're both businesses that favour a long-term, sustainable approach. Deere works closely with farmers to maintain the biodiversity of their land for the future, much in the same way as we preserve and grow wealth for the next generation.

Over the centuries, these and other shared values have helped our businesses survive some of history's biggest shocks, from world wars to global depressions.

Like us, Deere also understands the power of networks. The company has developed loyal relationships with dealers and multi-generational farming families up and down America.

That's why we expect Deere's distinctive green machines to remain an iconic part of the country's rural backdrop for many years to come.

⁶ Agents for the Rothschilds: A Nineteenth-Century Information Network

⁷ The Original Steel Plow

Our network in action: understanding Asia

With nearly 4.5 billion people spread across roughly 50 countries, it almost goes without saying that Asia is a vast market with tremendous diversity.

Obtaining even a bird's eye view of the best opportunities across such a complex ecosystem is no easy feat. Many investors don't even try, instead focusing their energy on the larger, more established companies and sectors in China and India.

That's not to say there aren't great opportunities to invest in those markets; there are, and we do.

However, many exciting smaller businesses often fly under the radar. These companies can have huge growth potential, and today's challengers may very well turn out to be tomorrow's incumbents. But without a local presence, researching and monitoring them is tricky, so they're easily overlooked.

We're able to tap into some of the unique opportunities that such businesses provide through the Ward Ferry Asian Smaller Companies Fund.

We have a close relationship with the Ward Ferry team, which is based in Hong Kong and led by Scobie Ward and Vineet Mitera.

They prioritise on-the-ground research, meeting hundreds of small companies across Asia every year. It's a personal, hands-on approach, which has helped them build a vibrant regional network and unearth opportunities that many investors would miss.

We first began investing in Ward Ferry in 2015, and it's always been an active partnership, with our research teams regularly visiting Asia to learn more about the businesses they value.

Earlier this year, we spent some time with portfolio manager Vineet, and he took us to meet over a dozen companies in the region. The trip helped reinforce what we already knew; Ward Ferry has a meticulous research process, underpinned by specialist knowledge and a strong local presence.

We returned home confident that our partnership with Ward Ferry would continue to bear fruit for our clients.

Similarly, we wouldn't invest in a business without thoroughly getting to know its management team. We also talk extensively with the company's former and current employees, as well as its suppliers, distributors, customers and competitors.

Our aim is to view the business from every possible angle, and our network is vital to making that happen.

Phone calls and emails may be convenient methods of communication in a pinch, but we much prefer to take the time to meet face to face, as it helps us to better understand and appreciate a company's culture. We want to see the day-to-day hustle and bustle of a business for ourselves, and that information can't be gleaned from numbers in a spreadsheet.

With that in mind, our research teams are regularly on the road, attending industry events and conferences, talking to subject matter experts and taking tours of offices, factories and plants worldwide.

Even if a business doesn't quite meet our investment criteria yet, we keep the communication channels open and active to cultivate the relationships we've already started to develop. We always want to be ready to act should anything change in the future that could affect our decision to invest in that company.

Our external fund manager network

As well as investing in companies, we also invest in specialist third-party funds. These relationships are incredibly important to us; we don't see our external managers as just suppliers, but as extensions of our own investment team.

When choosing who we want to work with, we look for only the highest-quality managers. They often share our investment approach, yes, but they must also add value and not just replicate what we say and do.

It's a delicate balance, and an important one to get right.

Our relationship with Bares Capital may offer some insight into what we mean. The fund is managed by Texas-based investor Brian Bares, who we met through our network at an event in Omaha, Nebraska in 2015.

We quickly saw the Bares Capital team sought similar qualities to us when they invest. They look for businesses with sustainable competitive advantages, strong leadership and clear potential for growth.

In other words, their investment philosophy closely aligns with our own, and the results speak for themselves. We target double-digit returns, which Bares has historically delivered.

But beyond that, the company has also been instrumental in improving our broader understanding of key markets and investments from a US perspective. Their insights have helped complement our own in-house analysis into everything from mid-cap tech companies to complex travel and booking platforms.

Our network of external managers acts as our eyes and ears (and brains!) on the ground in markets where we believe there is untapped potential.

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Conclusion

Strong networks are by no means exclusive to family-owned companies.

That being said, we believe Rothschild & Co has a culture of collaboration, trust and honesty that is unique to businesses with long histories and deep-seated family values such as our own.

These firm foundations have helped us preserve and grow our network, so that we can, in turn, continue to identify the best opportunities to preserve and grow clients' wealth.

And no discussion about the power of our network would ever be complete without thanking you, our clients.

As some of the world's most successful industry leaders and entrepreneurs, your insights and opinions remain a valued source of information and inspiration. Without them, our investment decisions would be that much harder.

Notes

At Rothschild & Co Wealth Management we offer an objective long-term perspective on investing, structuring and safeguarding assets, to preserve and grow our clients' wealth.

We provide a comprehensive range of services to some of the world's wealthiest and most successful families, entrepreneurs, foundations and charities.

In an environment where short-term thinking often dominates, our long-term perspective sets us apart. We believe preservation first is the right approach to managing wealth.

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