



Mosaïque Insights

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“War does not determine who is right – only who is left.”



Laurent Gagnebin
CEO, Rothschild & Co Bank AG

This Spring saw many emerge from a second winter of Covid-19 restrictions as we learn to live with the virus. It is a time of renewal but also increased uncertainty from the geo-political events which unfolded in the first quarter of this year.

Reminded by the wise words attributed to the philosopher Bertrand Russel, war does not determine who is right – only who is left. Our thoughts go out to all those affected by the war in Ukraine.

The events of the last three months remind us of the importance of maintaining a long-term wealth preservation strategy, one which gives perspective, seeks to understand the present and moves in anticipation of the future. As set out in the following articles our investment team and strategists have been moving swiftly, dialling back the market noise and positioning portfolios for times ahead.

Whether it's inflation, rising interest rates, supply chain bottlenecks or the ramifications of sanctions on a less globalised world, we bring you our latest thought leadership, views and analysis during this season of change.

Drawing on seven generations of wealth preservation, it is our collective knowledge across the centuries which serve as our most valued asset to our clients. We look forward to continuing this service, safe in the knowledge that what has come before will come again.

We look forward to seeing you soon

Bis bald, à la prochaine



Dr. Carlos Mejia
CIO, Rothschild & Co Bank AG



Values: all data as of March 2022



Did the long-term outlook just change?



Kevin Gardiner

Global Investment Strategist

Kevin Gardiner

An ex-colleague used the following disclaimer: “These are my current views, and they are subject to change without notice”.

Stating in advance that your views might suddenly change seemed an admission of defeat, particularly if you’re claiming to take a long-term view. But I have come to appreciate their candour.

Sometimes the investment climate, not just the weather, does change abruptly. It did so in 2008, when Lehman’s collapse pitched us into many months of financial firefighting. It did so more profoundly in the early 1970s, when surging real oil prices effectively trashed economic prospects for a decade, along with many previously viable long-term business models, even though it was not immediately apparent at the time. It took years then for a more temperate climate to re-emerge.

Most of the time, incrementalism fits the facts better. Beneath the seemingly chaotic headlines of the last half century there has been a simple, gradualist narrative in which technology and the learning curve have lifted living standards, in a world that has grown healthier and safer (and closer).

But Russia’s actions, and the rationale offered for them, have interrupted – and could conceivably reverse – that narrative. “Looking across the valley” is more difficult than usual.

As yet, the jury is out.

It is not possible to identify all the potential outcomes. Diplomats and militarists are divided, and what can we know about the situation on the ground anyway? We are blessed with a free press, but not necessarily an objective one: if we mostly share the same emotions and hopes, groupthink is not far away.

So, as we count our blessings and try to gauge the narrow investment impact of these dreadful events (it seems tasteless even to try), we find it easiest to think in terms not of a list of probability-weighted scenarios, but instead to picture a pendulum suspended between the two polar outcomes of war and peace.

The grimmest outcome is sadly most visible as we write. Conflict and economic disruption might spread; China, not just Russia, could become

uninvestable (as it is, MSCI China is looking cheaper, compared to the wider world, than at any time since it joined the WTO). Were this to happen, of course, investment performance might be the least of our concerns.

But peace must still be possible too – and perhaps even a more stable one than the situation before February 24th. China, disappointed (poorly briefed?) by its ally, might help the pendulum swing that way. So too might an elder statesperson, trusted by Russia – as might the EU deciding (realising) that the cost of doing without Russian oil is bearable. But believing in such an outcome currently feels more like a leap of faith than reasoned analysis.

For the time being, then, we assume the pendulum will remain somewhere in the middle: that conflict will continue but remain contained in scale and geography.

The immediate macro impact is clear: (even) more inflation, and less growth. The inflation comes from the extra squeeze on energy as well as other commodities, and from supply-side disruptions and sanctions. The threat to growth derives from those higher costs, the disruptions, and from the likely impact on consumer and business confidence of the first threat to global peace in our working lifetimes.

This is understandably prompting talk of stagflation, that is, output “stagnation” with price “inflation”. The word was first used to describe the difficult macro climate of the 1970s (and early 1980s), the one noted above.

Such a mix is perhaps the most difficult for conventional portfolios. Poor growth is bad for business and stocks, while high inflation is bad for bonds and other nominal assets – there is no obvious hiding place.

But as noted, if an overnight paradigm change is possible, the jury is still out on whether we do actually face one. Until that pendulum swings more firmly, we can’t gauge growth prospects, or where inflation will settle. The original stagflation lasted for years, and in retrospect had been brewing for years too, though it took OPEC to catalyse an altered climate. For the time being, we stay positioned for higher interest rates and for slowing, but still positive, growth.

Note from the CIO

Building on our Global Investment Strategist's analysis, the first quarter of 2022 was not for the faint-hearted. It is at times like this, as at the onset of the pandemic, that we must remember our long-term wealth preservation strategy. This meant enacting tactical changes at an Asset Allocation level as well as reinforcing our security selection process. For the latter our equity analysts now work in partnership with leading Equity Research House, [Redburn](#).

Over the quarter, the build-up and subsequent invasion of Ukraine by Russia along with sustained inflation and the prospect of rising interest rates, required us to move quickly and decisively. As set out in our Mosaïque Views below, we reduced our exposure to equities, increased cash and our defensive positioning across equity regions and sectors. Each incremental piece that we adjust must ultimately make sense in the whole – this is the essence of the Mosaïque Strategy. Looking ahead, we remain focused on the possibility for turbulent times and will review our asset allocation as frequently as is required.

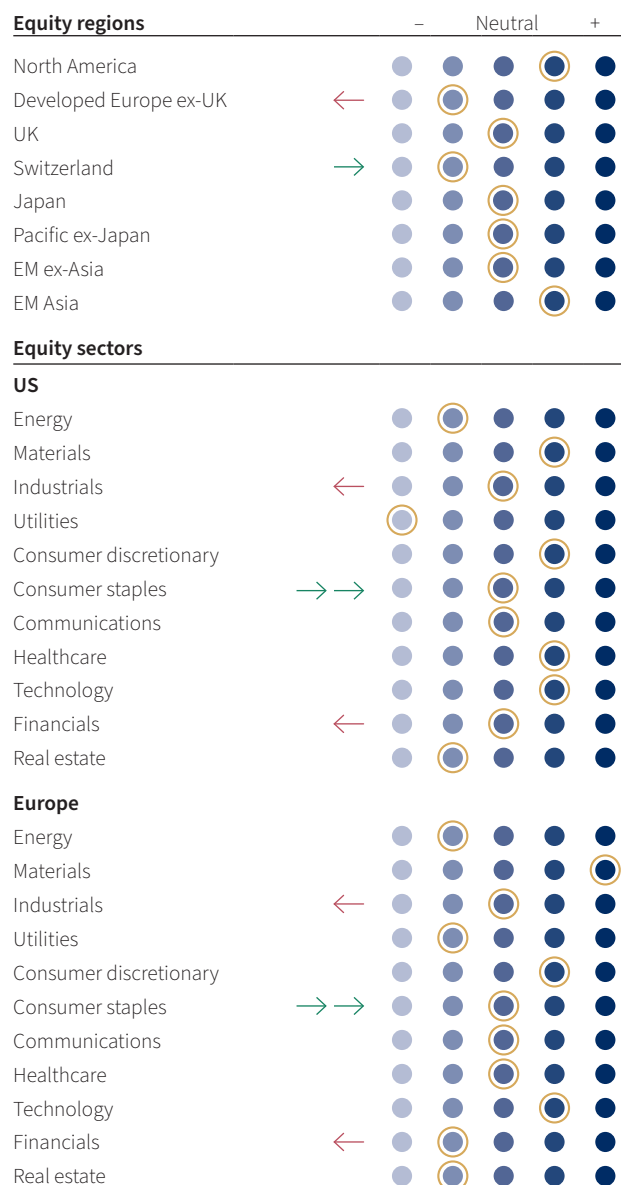
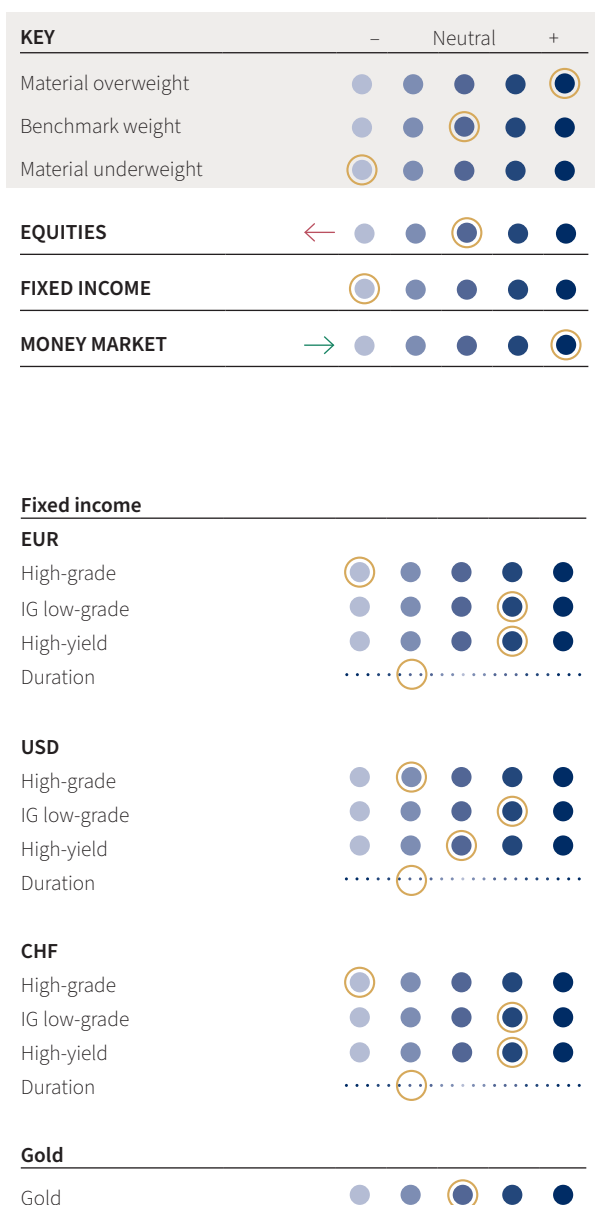


Dr. Carlos Mejia
CIO, Rothschild & Co Bank AG

Our Mosaïque Views

By asset class, region and sector

↔ Changes made to our Tactical Asset Allocation in Q1 2022





Notes from the Manager



Clément Boisson
Portfolio Manager

After a strong year for equity markets, 2022 was tipped as the year when the world economy would make a full recovery from the fallout of the pandemic. Reality and narratives rarely coincide. As we all know, investors have battled a tough first quarter, one in which geo-political events have overshadowed economic momentum and aggravated pre-existing supply chain and inflationary pressures caused by the pandemic.

With Covid-19 restrictions lifting in most countries, inflation was already a key discussion point, touching multi-decades high in the US and Europe. As discussed by our global investment strategist, Central Banks are moving quickly to tighten monetary policy and wind down asset purchase programmes as they seek to curb inflation. With an eye on the markets, fixed income and equity markets both suffered although price falls have focused primarily on fixed income in recent weeks where sovereign yields are touching multi-year highs. Looking at equities, value stocks were outperforming growth stocks (see below) by some 11% - a historically large gap.

VALUE STOCKS Stocks where valuation appears cheap

GROWTH STOCKS Stocks which are anticipated to grow at a rate significantly above the average growth of the market

Turning to events, Russia's invasion of Ukraine was the single largest market-moving event of Q1 2022.

Unsurprisingly, volatility rose and equity markets fell, with supply-chain disruption from sanctions and soaring energy prices likely to impact household and corporate incomes in the months ahead.

It is no surprise that markets did not take well to this environment and the quarter proved difficult for portfolio managers –

particularly where we are positioned for the long term and do not chase short-term market volatility. That said, we did take some tactical decisions in the light of Q1 2022 events.

Taking a view that the war in Ukraine was unlikely to end in a matter of days or weeks, we decided to review our strategy and as a result systematically reduced risk in our tactical positioning. As discussed by our CIO, we moved from overweight to neutral equities and moved double overweight cash. Equally, we moved down one position in Europe (ex. UK) and moved up one position in Switzerland – a defensive regional move.

After conducting a systematic analysis of potential equity exposure to Russian and Ukrainian markets, we were satisfied that Mosaique portfolios have minimal to no direct exposure. Those equity positions with the largest percentage of revenues in the region are listed in the table below. As many of these companies close their operations in Russia, we expect these numbers to fall.

% Revenue exposure to Russia

American Express	2-4%
Epiroc	6-7%
Estée Lauder	3-4%
LVMH	2-4%
Mastercard	4-6%
TotalEnergies	3-5%
Visa	4-6%

as at 09.03.2022

On fixed income, we decided not to change our strategic stance and remained materially underweight. While interest rates fell at the onset of war in Ukraine, the long-term trend is clearly for interest rates to go up. We indeed saw an acceleration of this trend by the end of March, with inflation and monetary policy coming back to the forefront of investors' concerns. In this environment we want to keep duration short and adjust tactically when we see markets overreact.

To conclude, balanced portfolios are down 5.3% to 5.9% YTD depending on the currency, broadly in line with competition as measured by the ARC Private Clients indices. We believe times ahead will be challenging, and protection against inflation will be at the forefront of our minds. We firmly believe that our strategy focusing on real assets is the correct one in this environment, and a careful stock selection process will be key to ensuring the long-term preservation of wealth.

Figure 1: Absolute Performance of Mosaique Portfolios

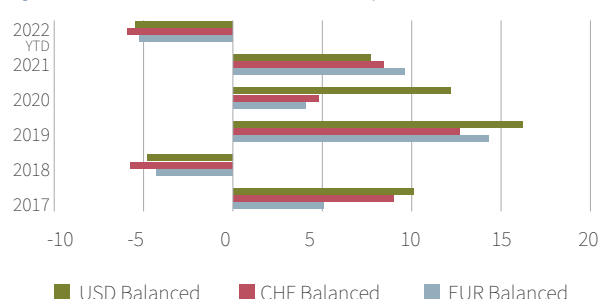


Figure 2: Mosaique Performance Relative to ARC



At the time of publication, Q1 data was not yet finalised reason for which performance is displayed until December 2021.



In Times of War: A look at the efficacy of sanctions



Lord Sedwill

Senior Advisor

Lord Sedwill is a Senior Advisor to Rothschild & Co and served as the United Kingdom National Security Advisor from 2017-2020 as well as Cabinet Secretary and Head of the Home Civil Service to the UK Government from 2018-20. He was previously the UK's ambassador to Afghanistan and the NATO Senior Civilian Representative in Afghanistan in 2010.

Interviewed by:
William Haggard
Head of Investment Insights

23 March 2022

In the following interview we discuss the economic efficacy of sanctions in the Ukraine conflict and take a long-term view on how diplomatic channels have built a road to peace.

The Russian-Ukraine war has triggered the imposition of economic sanctions on Russia. How do these sanctions compare with previous sanctions imposed in times of conflict?

In the latest conflict we have seen a mixture of broad-based economic sanctions coupled with targeted sanctions aimed at the Kremlin and connected oligarchy.

The use of a mixture of general and targeted sanctions has developed in response to the 1990s when the UN and the West imposed stringent and widespread economic sanctions on Iraq following its invasion of Kuwait. These sanctions stayed in force for over a decade and had a severe humanitarian impact on the general population, including a significant impact on per capita national income, whilst failing to isolate the Ba'athist ruling regime in Iraq. In retrospect, these sanctions helped to entrench the regime giving them greater control of the local economy through sanctions-evading supply chains.

To what extent can sanctions be effective and how should we measure their efficacy?

Whilst sanctions may be economic in nature, their aims are political. The efficacy of sanctions should therefore be measured not in financial terms but in what - if any - change they can bring about at a political level. This can manifest itself in changing a regime's behaviour and / or the dismantling or building of a particular policy.

One of the best examples of the efficacy of sanctions in the last century was sanctions imposed on South Africa during the apartheid era. Coupled with economic sanctions, the cultural sanctions which saw the ban on sporting matches with South Africa helped change the mindset of a generation of white South Africans who felt the impact of being isolated from the outside world. This is one of the clearest examples in the 20th Century of cause and effect between the imposition of sanctions and an eventual change in government policy.

The New York Times recently published an opinion article calling for the US to use its sanctions “superpowers” wisely. What risks should be considered by the West when deploying sanctions?

As the World's largest economy, US engagement with sanctions is obviously key to making them effective. That said, gone are the unipolar years (think 1990s) where the US was the World's sole global superpower. In a multi-polar world of competing economic and political powers such as today, the need for unanimity in the adoption of sanctions is even more important. These days the US economy is highly intergrated with that of China and this limits the extent to which the US can wield sanctions on its own. For example, any sanctions levelled on China by the US would cause serious harm to both. The boomerang effect of sanctions on those imposing them in such a situation should not be understated.

Conversely, where a consensus can be built around sanctions, such as the UN-backed sanctions against Iran's nuclear development programme, which saw broad-based support from both the US and China, we see sanctions wielded with far greater efficacy. Coming back to my earlier point, imposing powers must make sure that sanctions are sufficiently targeted to hit those that matter. Otherwise, you face the risk of entrenching existing regimes within their own sanctions-evading black markets.

Beyond the immediate impact of the conflict, what secondary effects can we expect to see from the latest raft of sanctions?

Secondary effects will be felt from both sanctions and the wider disruption caused by the war on supply chains globally. An obvious and highly visible primary effect of the conflict has been the rise in oil and gas prices. Decoupling Europe's dependency on Russian energy sources will take time.

A secondary effect which will become more visible if the conflict draws out will be the issue of food security. Ukraine is a global exporter of grains, such as wheat and maize as well as sunflower oil, and the war has heavily disrupted this spring's sowing season. As Ukraine's grain exports fall short this year, there could be a knock-on effect for industries as diverse as Chinese livestock feed to Egyptian bread production. Whilst this may sound niche, one should not underestimate their impact: the Arab Spring began over food shortages and inflation. We should expect governments and the international financial institutions to monitor this closely and the potential impact of the war on supply chains in the coming months.

Aside from sanctions, what role can diplomacy play once conflict has begun? In your experience can diplomatic channels prove effective?

Once one country invades another country, the area for a settled diplomatic solution reduces or vanishes altogether. In the current conflict, it's not clear why President Putin needed to invade Ukraine in order to obtain its declared neutrality vis-à-vis NATO. Part of the challenge faced in finding a diplomatic solution in the present conflict is therefore the lack of clearly communicated objectives.

Looking back at history, there are many examples of diplomacy managing an end to conflict, but only when the fundamentals on the ground set the right conditions: the ceasefire at the end of the Korean War, the withdrawal from Vietnam and, perhaps most notably, the 1978 Camp David agreement which resolved the Israel-Egypt conflicts of the previous three decades. Diplomacy was also instrumental in managing a smooth end to the Cold War.

For now, it is hard to see a viable diplomatic solution to the Ukraine conflict and the more the war progresses the harder it will be to find a compromise. We should note that in the first couple of weeks of this conflict, sanctions and the targeting of Russian assets has broadened from select individuals to the wider Russian economy. Investors should expect Russia to remain outside the global economy for a considerable period of time – from a geo-political perspective, the ramifications of this conflict will be felt for years ahead.



“Investing is simple, but not easy” – Warren Buffet



Erdinç Benli

Head of Investment &
Portfolio Advisory



William Therlin

Investment and
Portfolio Adviser

When individuals are asked to rate their skills in activities such as driving or investing, the common answer is ‘above average’. The puzzling fact with this perception is obvious: Not everyone can be above average.

A FINRA study found that three-quarters of respondents had inflated perceptions of their financial literacy whilst only 59% of those perceived to have ‘very high’ financial knowledge could perform two calculations deemed ‘easy’ on inflation and interest rates¹. The same applies in academia: In one study, 80% of MBA students rated themselves above average within their cohort². This tendency for people to consider themselves above average is sometimes attributed to the Lake Wobegon effect, named after the fictional town “*where all the women are strong, all the men are good-looking, and all the children are above average*”³.

Investors in financial markets are unfortunately not shielded from certain biases when taking decisions, something, that could prevent them from taking rational actions.

Whilst traditional finance is centered on how individuals should behave (in efficient markets, assuming people are rational), behavioral finance focuses on how individuals in fact behave. The latter recognizes that biases can affect decision-making. In this article, we focus on the two biases we as investment professionals often encounter: the overconfidence bias and the endowment bias.

Stay humble

A market participant who tends to overestimate his/her ability or reasoning is said to suffer from overconfidence bias. In the context of investing, suffering from this bias may lead to:

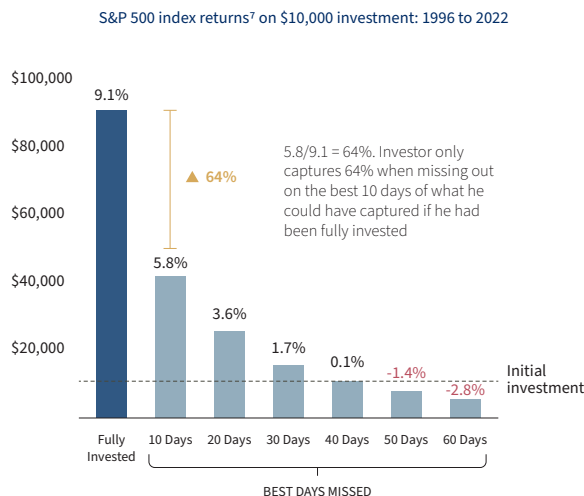
- I. Overestimating returns and underestimating risks
- II. Under-diversified portfolios
- III. Excessive turnover and high transactions costs, likely detrimental to portfolio returns⁴.

The third point can be illustrated by observing investment returns over time: A fully invested portfolio (see chart 1)⁵ would have generated over 9% annualized return between 1996 and 2022. Missing out on the best ten performing days would have generated only 5.8% annualized return. And missing out on the best twenty days would have generated below 4% annualized return.

The rudimental concept to “*buy low, sell high*” is far from easy despite investment professionals’ best efforts and the likelihood of successfully achieving this over time is very low. Standing on the sidelines for prolonged periods or trying to time the market may thus reduce returns significantly. *Overconfidence bias* can be linked to the *illusion of knowledge*: A feeling that one will be right e.g., knowing when to buy before markets go up and selling before markets go down.

We have obviously seen times during which not being in the market would have proven right in the short term. This, however, only holds true if investors know when to enter the market again, something, which is notoriously difficult. One example in recent history underlines this phenomenon: The Covid-induced drawdown in stock markets in March 2020 was historical, but the recovery was very swift - whiplash.

We are not making the case that no changes should be made to portfolios. Rebalancing, changing asset allocation, trimming positions, and taking action if investment thesis and economic narrative shift are all part of core portfolio management. However, as we have seen over time, staying invested and avoiding excessive transactions often prevailed over market timing⁶.



Stay disciplined

How can one mitigate the *overconfidence bias*? A diligent investment process is usually a good starting point. Portfolios should be reviewed regularly to identify any systematic patterns (good or bad), and to assess the merits of underlying investments. One essential but admittedly tricky task is to attribute successful investments to luck or good judgment (gains may be made in a bull-market even if the underlying investment approach can be deemed faulty). Finally, risk and return assessment must be challenged and portfolio diversification be considered and monitored regularly.

Don't fall in love

Asked if we prefer the green car we own over another identical green car (all equal except for the ownership), the answer is easy according to behavioral economists in line with the *endowment effect*. This concept was first identified in the context of loss aversion, where losses hurt more than gains of equal size⁸.

To illustrate the *endowment effect*, imagine a group of twenty individuals out of which 10 are given a bottle of

wine selling for \$15. Participants were then asked to form a market and one would expect, given randomly distributed wine bottles, trade to be quite high (some would think close to fifty percent). Instead, studies have shown trade was as low as ten percent. Why? Because potential sellers didn't want to part with what they owned.

Why is it then that individuals tend to ask for a (sometimes significantly) higher selling price for an asset in possession vs. their willingness to pay for the same asset if not owned?⁹ Perception of value seems to be distorted by ownership, even if the duration of ownership was limited. This forms the core of the *endowment bias*.

In the context of investing, we can see two common consequences of the *endowment bias*:

- I. Holding asset(s) we are familiar with, driven in part by some intangible value of comfort
- II. Failure to sell an inappropriate asset (since additional value is applied to assets owned), this could result in a sub-optimal asset allocation.

Become less familiar with familiar assets

One example of the *endowment effect* can be inherited assets. In order to mitigate this bias, the investor has to question if the same assets would be purchased in a new portfolio today, or if ownership is merely a consequence of inheritance.

Taking a step back forms an integral part of a diligent investment process in the context of such intergenerational assets. In such scenarios, we must stress the importance of trying to objectively review such assets by attempting to discount for values of familiarity or comfort. That said, we would not advise owners of potentially inherited portfolios to simply dispose of all familiar assets arbitrarily; some inherited assets may stand the test of time.

The same holds true for assets beyond those potentially inherited: A diligent investor must challenge the status quo (yet another bias) and challenge the merits of current investment assets. This is not to say excessive trading is required - we like to refrain from this as we have discussed. However, having a review process of investment assets in place to ensure they remain fit for purpose should be a part of all investors' regular portfolio health checks.

Having said that it might make sense to look under the hood and hold on to that green car after all...

1 Financial Industry Regulatory Authority - https://www.usfinancialcapability.org/downloads/NFCS_2018_Report_Natl_Findings.pdf.

2 Shefrin, (2007), *Beyond Greed and Fear: Understanding Behavioral Finance and the Psychology of Investing*, Oxford University Press.

3 For wider discussion see Montier, J. (2010). *The little book of behavioral investing: How not to be your own worst enemy*. John Wiley & Sons Inc.

4 Barber, Brad M and Terrance Odean (2001), Boys will be boys: Gender, overconfidence, and common stock investment, *The Quarterly Journal of Economics* pp. 261-292.

5 Rothschild & Co WM Strategy Team, Bloomberg, S&P 500 returns on total return basis, gross of fees.

6 Graham, John R. and Harvey, Campbell, (1996), Market timing ability and volatility implied in investment newsletters' asset allocation recommendations, *Journal of Financial Economics*, 42, issue 3, p. 397-421.

7 Rothschild & Co WM Strategy Team, Bloomberg.

8 Thaler RH. 1980. Toward a positive theory of consumer choice. *Journal of Economic Behavior & Organization*. 1(1): 39-60.

9 Kahneman D, Knetsch JL, Thaler RH. 1990. Experimental tests of the endowment effect and the Coase theorem. *Journal of Political Economy*. 98(6): 1325-1348.

The Energy conundrum facing Europe



Stuart Joyner

Partner and Energy Specialist,
Redburn

Interviewed by:
Laura Kuenlen
Investment Insights

21 March 2022

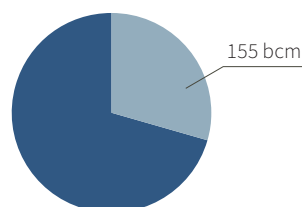
In the following interview, we discuss with Stuart Joyner, Partner and Energy Specialist at equity research house Redburn, the energy conundrum facing Europe in the wake of the Russia-Ukraine war.

Hello Stuart, for our readers what are the potential outcomes of an export blockade of Russian oil?

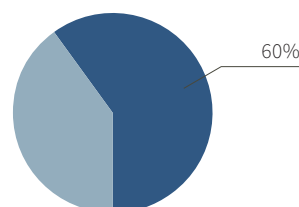
There is a wide range of potential outcomes. In a scenario where all Russian oil and product exports to Europe are blocked by a buyers' strike (and no alternative customer is found), the impact could be as high as 5 million barrels per day (Mbpd) of production. Conversely, if sanctions prove to be a relatively niche or short-lived response, the impact could be negligible. At the current time, beyond the anecdotal evidence collated above, we do not have enough information or data to be definitive and we have seen estimates of disruption ranging from 1-4Mbpd. What we can say is that based on our underlying supply-demand modelling, it would not require a large reduction in exports to see the market suddenly look very tight.

How much does Europe rely on Russian energy?

Russia is the third largest oil producer in the world (after Saudi and the US) and around 60% of its circa 5 million barrels per day of oil and product exports go to OECD Europe. Russian gas exports met 30% of European demand in 2021. Unlike the oil market, gas is a much more local commodity, and it would be extremely challenging if not impossible to replace Russian volumes in the short term. Europe consumed 524b billion cubic meters of gas (bcm) in 2021 of which 155bcm came from Russia.



155 / 524 bcm European
gas consumption comes
from Russia



60% of Russia's 5m bpd of
oil produced is exported
to OECD Europe

How disruptive is recent headline news for the energy market and how much higher do you see energy prices going?

Although there has been no damage to oil and gas production from the fighting so far, the impact from government sanctions has been material. This has been reflected in increased oil price volatility in recent weeks. Currently there is no evidence that gas flows have been disrupted, but supply was already struggling to keep up with the rebound in demand post the pandemic coming into the current crisis. Inventories are at the bottom end of their 5-year range and Russian exports to Northern Europe were already running at low levels year-on-year even prior to the invasion of Ukraine. With this in mind, we believe that prices in the near-term will continue to be driven by geopolitics and it's hard to predict the outcome. Given the YTD rally in commodity prices such as oil, it is clear that our 2022 gas price assumptions will have to be revised upwards.

In light of Europe's dependency on Russian energy sources, will we see a shift to deglobalisation when it comes to energy security for the world's major economies?

Energy has globalised at a rapid pace over the last few years, with access to low cost, low carbon energy trumping security of supply for most importers. We do now expect this to reverse somewhat as a result of the effective removal of Russian supply from much of the West. Governments will likely lean into renewables and especially nuclear to have access to secure low carbon energy. An exception to this trend will be US gas exports to Europe which are expected to grow rapidly.

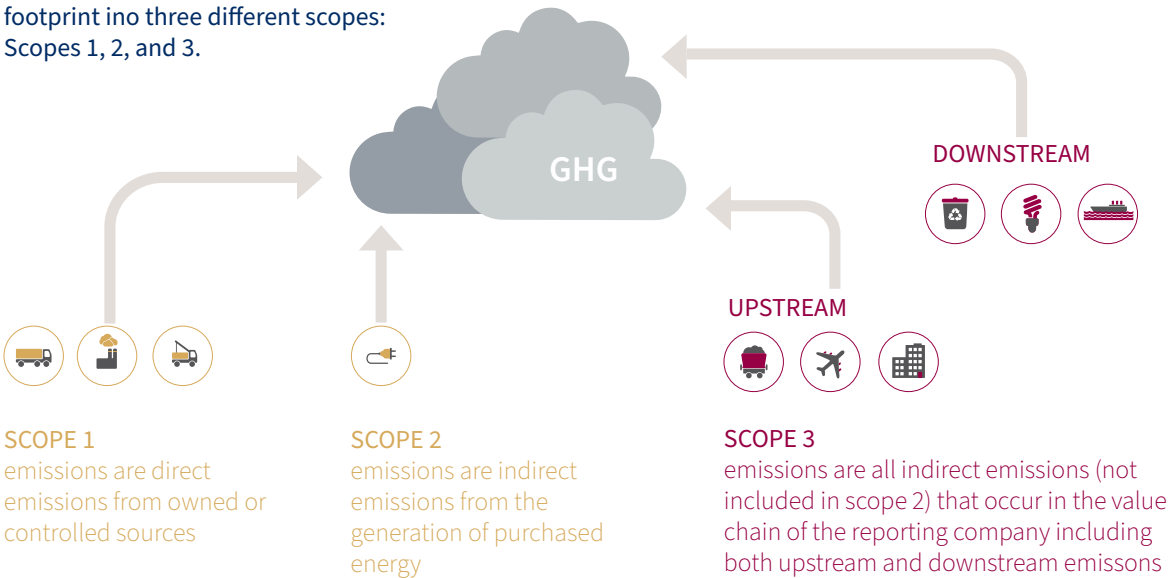
Looking to the future and the roadmap to net zero: What opportunities are there for oil and gas companies?

In 2019 we conducted a study of European Oil Majors - being TOTAL, BP, Royal Dutch Shell, Eni, Equinor, Repsol, OMV, Exxon, Chevron - which had outlined initial plans to expand into renewables. At the time, we estimated spending on renewables across the group of companies was circa \$8bn per annum, less than 10% of their total capex. However, in the intervening period, companies have accelerated their transition strategies to carbon neutrality, almost doubling the proportion of capex allocated to this area. We now forecast that up to a quarter of the European Majors' capex in 2022-25 will be spent on renewables and other low-carbon businesses. We believe one of the primary drivers of this increase in renewables spending has been an acceptance that the Majors will ultimately be held responsible for scope 3 (customer) emissions. All the European Majors have now issued scope 3 reduction targets that commit them to becoming net zero by 2050. Whilst the scope and definition of these vary, all require a material reduction in emissions.

Scope 1 / 2 and 3 definitions (see infographic below)

To meet these targets, the Majors will have to increase their exposure to low-carbon energy products as well as investing in carbon offsetting projects to reduce oil and gas output. This necessitates the increase in renewables capex witnessed in the past year or so. The transformation will not be quick. Our new renewable modelling suggests it will take decades for the Majors to fully transition their businesses but we forecast that a minority of operating cash flow will come from renewables and low carbon energy sources by 2030.

The Greenhouse Gas (GHG) protocol categorizes a company's GHG footprint into three different scopes: Scopes 1, 2, and 3.





A US Road Trip: Views from the analysts



Christoph Wirtz
Equity Analyst

After nearly two years of working remotely we were able to hit the road in December 2021. Our destination New York and Boston – the targets: Thermo Fisher, T Rowe Price, American Express, Moody's, S&P as well as some new candidates for future investments.

Rarely has it felt so good to travel and we took the strategic opportunity to drop in on a Financials conference in New York. These events - much missed during the pandemic - are always helpful in getting a sense of what people are talking about and where's hot in the market. Needless to say there was plenty of discussion around cryptocurrencies.

Our first visit was to American Express's headquarters in New York. Given AmEx's focus on payment card services, the company was hit particularly hard during the pandemic when its customers were unable to spend on dining, travel and shopping. How refreshing it was therefore to see that the company has grown confident enough to issue its first long-term revenue forecast since the beginning of Covid-19 - customers appear to be adapting to the reality of the pandemic. We've seen cardmember spending rise above pre-pandemic levels in the third quarter 2021, a growth, that continued into the fourth quarter. From our visit it was clear that AmEx seems confident that there will be a sizeable comeback in travel this year, which they will be able to profit from.

Our next visit was to the headquarters of Moody's. As part of their product offering, Moody's offers solutions such as insurance & actuarial analysis, weather & natural disaster analysis and other financial data solutions. We took the time to discuss some internal as well as external tools they have developed which help their customers, for example, to evaluate the risk to properties

from earthquakes for lending purposes. One of the tools we discussed can map soil layers to see whether properties are located in soft soil layers more prone to the damaging effects of earthquakes. This information can serve banks to better understand their lending exposure to properties which will give rise to potential claims and loan losses. What's also interesting is how these tools have brought down earthquake risks from an underwriting perspective, as insurers can better understand the exposure of properties (or not) to future earthquakes. It's insights like these which give us a more granular understanding of Moody's product suite and potential for new market growth.

After a short but exhilarating stay in New York it was time to travel up the coast to Boston where we visited the headquarters of ThermoFisher Scientific. In our experience, and this was confirmed on our trip, visiting the headquarters of a company is an essential part of knowing a business, its culture and how it sees itself. It is something a lot of investors shy away from, as headquarters are often based in far-flung places which take time to get to. We think this inconvenience is almost always worth it.

Thermo Fisher is an American supplier of scientific instruments, reagents, consumables, and software services. Over the last decade, they have undergone some significant transformation and grown from USD 11bn in sales in 2011 to USD39bn in 2021, driven by a track record of organic and M&A growth. At the same time, they have kept a nimble and lean approach, as witnessed when visiting their headquarters where only 300 employees work. This is a remarkably small amount of people, considering the company employs around 40,000 employees on a global level. At the same time, it underlines the decentralized nature of the business.

With a market share of around 23%, Thermo Fisher is the largest company in the USD170bn life science tools and diagnostics space. The company displays many of the characteristics we admire: It has a well-diversified customer base, including pharmaceutical & life sciences, with exposure to industrial, academic, and governmental end-markets. Recurring revenue levels are high, with 51% of sales generated from consumables, reflecting the stickiness of products included in complex customer processes. ThermoFisher also generates attractive operating margins, which are trending upwards over time.

Fighting Covid-19

During the pandemic, ThermoFisher stepped up its game and played an important role in enabling COVID-19 PCR diagnostic testing around the world. At the end of 2021, around 20-25% of all the PCR tests were running on their platform and the company plays a major role in supporting a wide range of major vaccine therapy projects from BioNTech to Moderna.

After analysing the industry and specifically the company over several months, it was essential that we visited its headquarters.

After a whistle-stop tour, we returned to Europe in the grips of the Omicron Covid-19 wave. The US was to follow shortly and we were fortunate to seize our moment on the East Coast. Journeys like these help build our investment cases and it is through these careful and methodical field trips, that we can build a long-term picture of the businesses we own as part of our long-term wealth preservation strategy.



What is the best course of action when investing in real estate?



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Real Estate

Hermance Capital Partners (Hermance) is an investment boutique focusing on private markets created in 2015 and acquired by Rothschild & Co in 2021. Hermance provides a wide range of private market investment solutions across high-conviction strategies with attractive risk-return profiles.

Over the last twenty years, the real estate sector for investors has matured. As a result, it now offers a wide range of strategies for various investment risk profiles:

- More passive, low risk/return real estate investments generating income (core strategy);
- More involved, private equity type real estate investments generating capital gains (value-add strategy).

Investors can use these strategies to position themselves with regards to the real estate cycle as well as rising interest rates and inflation.

Core strategy

Core real estate assets have yield characteristics that are similar to bonds. These assets have been popular during the last few years in a low interest rate environment. Core investments are generally found in traditional sectors such as residential property or office space and are quality assets with high occupancy rates (>90%) as well as sustainable rental income. More recently, other mature real estate sectors such as logistics have been added to the core offering. Investing in core assets is generally passive in terms of the operational management of the asset and the intention should be to hold such assets over a long period of time to capture regular income. As this investment profile is rather conservative in nature, the level of debt used remains moderate, generally ranging from 25% to 50% of the asset value. Performance depends on geography and sector. In Switzerland, for example, an investor can receive annual distributions between 2% and 5%, depending on the leverage applied. Typically, these investments are available through direct ownership or through listed as well as open-ended funds, offering liquidity to investors.

Value-add strategy

Private equity real estate is less known to private clients due to its complexity, illiquidity, and minimum investment size. The investment goal is to generate a capital gain of more than 1.5x the amount invested over a holding period of 3 to 5 years, using an average leverage between 50% and 70%. This approach targets properties with a potential for capital appreciation and subsequently stabilizing the asset through significant operational and strategic changes. The activity is carried out on a global scale via specialized managers, both in traditional real estate sectors that are in need of transformation and in new sectors that are still

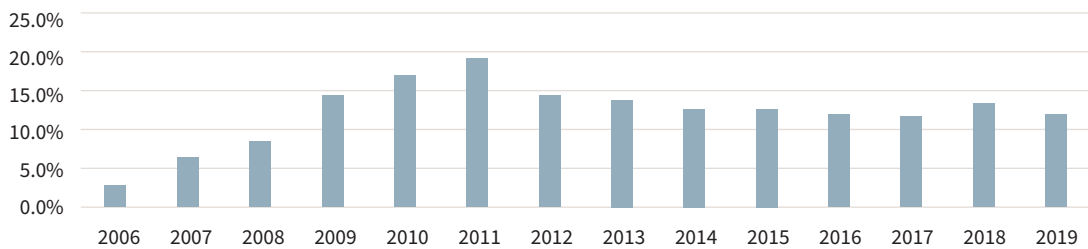
fragmented. Examples include office buildings that need to be repositioned in terms of space planning or sustainability or new trends such as digital data storage sites, student residences and research laboratories. At the same time, private equity real estate players are using various investment methods to acquire assets and create value, including different entry points at the capital structure level or building platforms around themes.

Our offering

Since its first investments in 2015, Hermance Capital Partners has favoured an active value creation philosophy aimed at being decorrelated from the economic cycle while maximizing performance. We have done so by partnering with management teams on the ground who can identify neglected assets, reposition/transform them, and ultimately unlock value in the final sale instead of solely relying on market growth.

In the current economic environment of uncertainty and market stress this value-creation approach can prove particularly attractive. Historically, periods of crisis have generated new investment opportunities through acquisition discounts, asset repositioning needs and the emergence of new sectors such as data centers, lab space and student housing. At the same time, while real estate has natural hedging characteristics against inflation, the work of increasing revenue through improving assets will help to offset the impact of rising interest rates, which is more difficult to counter with passive strategies. The chart below shows the post 2008 performance (net median IRR in % per vintage year - source Preqin) of private equity real estate strategies focusing on value creation. It illustrates not only the outperformance of this investment approach following times of crisis but also its resilience over time.

Net Median IRR% per Vintage Year



Source: Preqin, 01.01.2006 - 31.12.2019. We have not included more recent IRR figures as they are less meaningful.



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