

Insync Quarterly Insights

11 May 2018 | Insync Fund Managers

What can we learn from the last quarter? From January a noticeable increase in volatility in equity markets re-emerged and looks set to stay. Insync's approach has greatly benefited from the return of market volatility, delivering results above most of our peers. In other words, it's back to normal, but why?

Rising inflationary concerns resulting in the Central Banks possibly being forced to lift interest rates greater than expected. This was then followed up later in the quarter by the US announcing trade protectionist tariffs and increased debate on regulating the largest technology companies. Whilst the latest headline economic data in the USA continues to improve, the ability of many companies to continue to lift profits and earnings is now under question.

In these times our disciplined use of megatrends® that identify companies most likely to continue to grow their financials in a healthy way comes to the fore. The new US Fed Chairman raised interest rates 25bps as anticipated and signalled further hikes as the year progresses assuming that economic strength is sustained. The Bank of England, like Australia, left its benchmark rate unchanged at 0.50% but similarly indicated it would likely raise it as soon as the second quarter. The ECB and BOJ have thus far been the slowest to adopt a tighter stance. However the ECB is hinting it may soon begin paring monthly asset purchases. Thus key Central Banks are moving in the one direction together, yet with staggered time lines this time around.

Generally we see volatility as a positive and don't fear its short term impact on stock prices in our portfolio. It was its absence that was worrying. Our view outlined in the March Monthly update remains unchanged. That is we see more probability of further falls in the AUD\$ against the USD\$ than a rise. Thus we remain unhedged.

The Scoreboard

Our view is the increase in volatility is here to stay and that's mostly a good thing for Insync investors given our use of megatrends® and our strong focus on downside risk management to 'sort the wheat from the chaff'. Indeed it is always a long term function of healthy markets, the last 7 or so years a historical aberration fuelled by too much cheap and easy capital; capital supply that is now beginning to taper off. In this environment the fund has excelled – as it should. In uncertain times we rise to the occasion.

A quarterly return of 6.1% before the cost of protection and after fees. The benchmark returned 1.1%. After the cost of protection and fees the return was still a strong 3.8%. For the year ending March the fund

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returned 16.98%, after fees and the cost of protection. Again this was ahead of the benchmark of 14.5%. The fund participated in 74% of upside markets and avoided 46% of downside markets.

Never forget the two key differences between Global Titans and other global equity funds on offer is that you enjoy catastrophe protection (via Put Options) and accessing a rare investment style in Australasia - Quality.

The Good; The Bad; The Ugly

The Good; Our focus on quality stocks that can deliver through periods of uncertainty and turmoil pays off for our investors. Top performers during the year ending March were PayPal, Zoetis, Visa, Microsoft and Cognisant Technology Solutions. Top performers during the quarter included Cognisant Technology Solutions, Zoetis, Booking Holdings, S&P Global and Microsoft.

The Bad; As always there will be detractors to performance over short time periods. These were Celgene, Walt Disney, Charter Communication, Reckitt Benckiser and Biogen for the year end. The main detractors for the quarter were Celgene, Biogen, Facebook, Reckitt Benckiser and RELX.

The Ugly; We exited two of the major detractors over the quarter and for the year. After our usual regular close review of the portfolio we concluded there are growing structural pressures which will limit three stock's capacity to perform going forward. We made reference to the pharmaceutical sector in the December quarterly with the continued negative rhetoric around drug pricing. The fund continues to have a low exposure to the sector with the fund's exiting its position in Celgene during the quarter.

The fund also exited its position in Reckitt Benckiser (a stock held since the fund started). We have admired the management who have had a ruthless focus on driving shareholder value through strong capital allocation delivering compound annual shareholder returns significantly in excess of the stock market for over 15 years. However consumer based businesses that historically achieved their competitive edge through marketing and distribution through traditional channels are having their business models disrupted. Big brands are starting to lose their appeal and building a name, thanks to online, is now much cheaper if one has the right product. Even the best management teams are finding it extremely challenging to adapt to the pace of disruption. For similar reasons the fund also exited its holdings in Unilever. Both businesses have contributed strongly to fund performance since initial purchase but we feel the time to exit has now come. We wish them well.

Things to remember for coming quarters

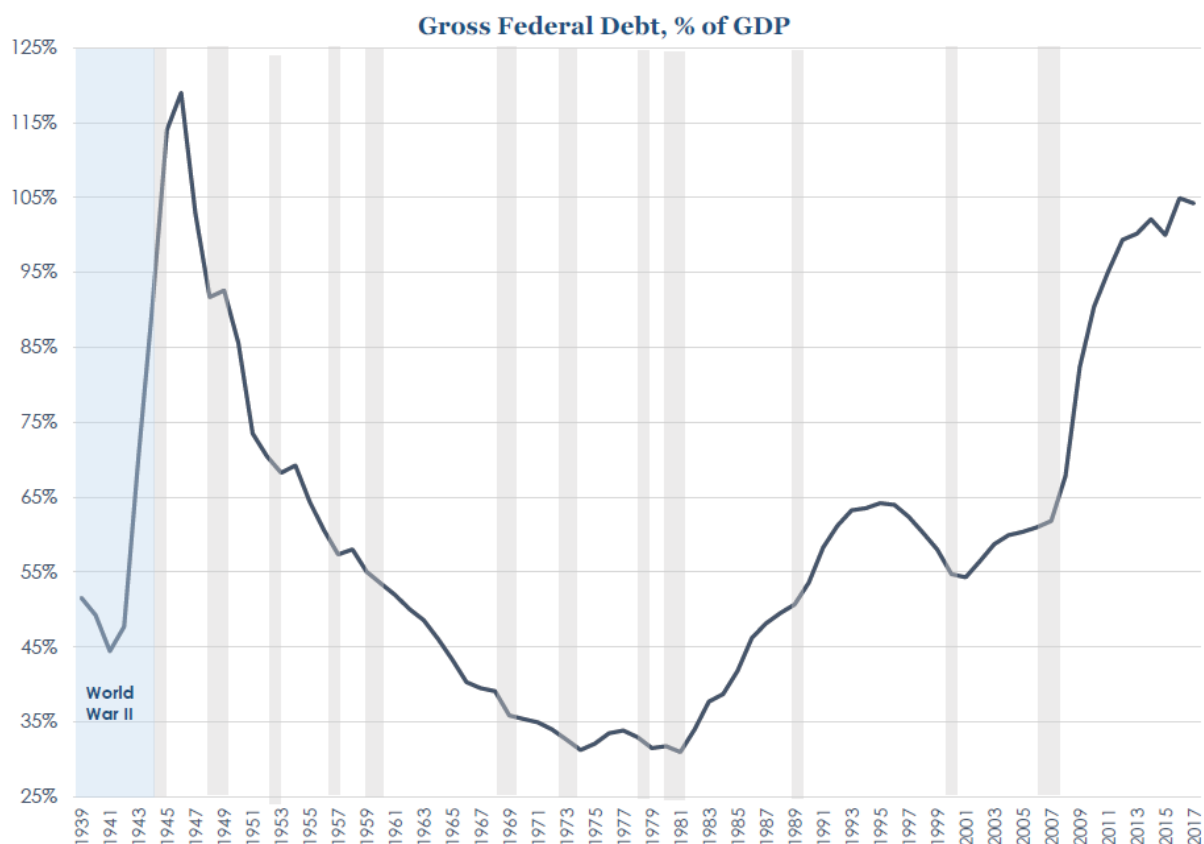
Nine years into a bull market is clearly a good time to think about downside protection. 5.2 years is the average between market catastrophes since the mid 60's. The average fall exceeds -32%. Yes you read that right. We now stand at a global historical record between such events. Like awaiting the next major

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earthquake in California or closer to home in New Zealand, its real and it will happen. Survivors of such events even thrive - if they are prepared.

This is a good time to look at the data - those facts most want to ignore. Historically, 5% market corrections have occurred about three times a year. 10% corrections about once a year and 20%+ corrections about once every three to four years. There is not one fact or new dynamic in place anywhere to say this level of severity and frequency will not continue to occur going forward. We accept the 5%ers, manage the 10%ers and focus on limiting the downside on the big ones – the 20%+ catastrophes. These can be truly wealth shattering.

This is the 10th year of global economic expansion; this is about as good as it gets. Most countries in the world are still running a fiscal deficit and massive debt. The U.S. debt-to-GDP ratio, at 104%, was only higher in 1945 and 1946, following the funding of World War II. China exceeds this by a factor of 3 and growing. This seems like a historically risky place to be in an investment context when the global economy has its next downturn. Central Banks cheap and massive debt expansion enabled nations and households to climb out of the last mess. By in large this 'lever' is no longer available for the next one to the degree it would need to be used.



Source: Federal Reserve Bank of St. Louis. Shaded bars represent recessions.

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Quality Style: What does this rare approach to investing mean for investors?

Quality investing works consistently over and within many market cycles. It often means you won't ride to the highest peaks of returns in a cycle, but nor are you likely to plumb the depths of the valleys or remain there for as long either. Due to this dual focus, an investor over time will likely enjoy greater wealth for less risk when applying the arithmetic on an account balance - not just referring to a 'performance table' alone.

Quality style means we own companies with high returns on invested capital that benefit from secular global **megatrends**®. These are supported by strong balance sheets and cash flow generation being well positioned to outperform in situations exactly like the current environment.

Global **megatrends**®, such as the rapidly growing working population in Africa or the move to a cashless society are less sensitive to economic cycles enabling the businesses exposed to these powerful irreversible trends to continue to consistently grow through the full investment cycle. It's why **megatrends**® are equally as important to holding a stock.

Insync is excited about the prospects for the companies we own for investors in markets such as this. We are also excited about some new ideas, which we continue to evaluate, and which may show up in the portfolio soon.

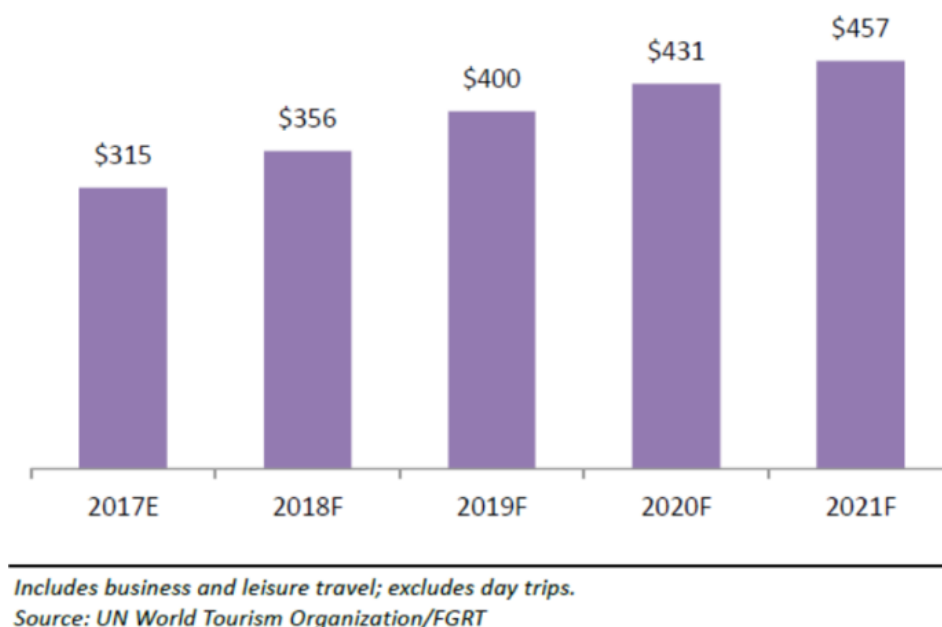
This Quarter's Megatrend® in Focus:: Travel & China's outbound tourists

Insync have identified the global travel megatrend® as a powerful secular trend that is benefitting from global consumers shift in spending towards experiences. Within this lies the secular growth in total overseas spending by Chinese tourists. With rising incomes, rising passport issuance and easing visa restrictions, China is expected to see significant growth in outbound travel in the next decade. China's outbound trips are expected to grow from 135 million in 2016 to 260 million in 2025.

Chinese outbound tourists will account for an estimated US\$315 billion in travel revenue in 2017 making them the world's biggest spenders on foreign travel. By 2021, it is estimated that their total overseas spending will reach US\$457 billion. Chinese outbound tourists have evolved into experienced and sophisticated travellers - some 67% of surveyed tourists have travelled more than once in the past 12 months, visiting an average of 2.3 destinations. This is an example of how we manage risk with China yet enjoy the upside that China can represent.

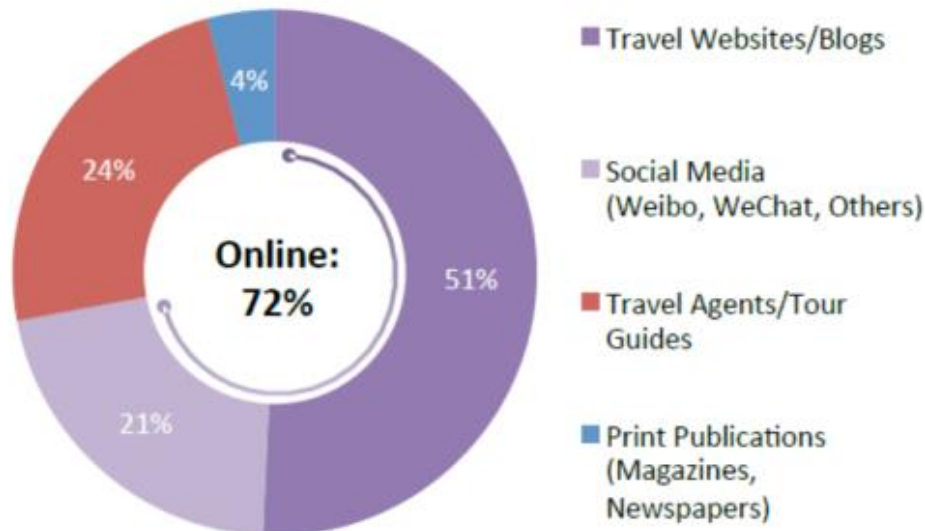
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Total overseas forecast spending by Tourists, 2017E-2021F (US\$ Billions):



Insync have invested in a number of high return-on-investment- capital (ROIC) companies that are benefitting from the powerful long term trends in global travel. The rapid increase in overseas spending by Chinese tourists over the next decade fuels a big part of this. One of our key holdings that benefits is Booking Holdings. Booking has a strategic investment in [ctrip.com](https://www.ctrip.com) the largest online travel agency (OTA) in China with just under 50% market share. Chinese tourists are extremely mobile-savvy, 98% of surveyed tourists used their smartphone abroad to keep in touch with others and to search for travel-related information. Walk in Paris, Sydney or Queenstown and you will see the evidence of this and the massive increase in Chinese exploring their outside world. Some 72% of surveyed tourists use online resources such as travel websites, blogs and social media to plan their trips.

Chinese tourists plan their trips with online resources:



A specific stock in this Megatrend®

This quarter's example is also a new holding we have taken during the quarter. **Intercontinental Hotel Group (IHG)** is the world's third-largest hotel group with a portfolio of 13 brands including InterContinental, Crowne Plaza, Holiday Inn, Holiday Inn Express, Holiday Inn Resort and the recently launched Avid. The next time you stay in one, you now stay in one as a part owner.

IHG's strategy is asset-light, primarily franchising hotels to third-parties or managing hotels on behalf of hotel owners. Of IHG's 786,000 rooms, 71% are in franchised hotels, 29% are managed by IHG and 0.3% are owned or leased by IHG. IHG is a beneficiary of the global megatrend® in travel with just the growth in outbound travel from China estimated to double over the next decade driving demand for quality hotel accommodation. The asset light nature of the business model enables IHG to grow units (rooms) and profits to shareholders with minimal capital invested. Travel is part of our silver megatrend® in the Demographics cluster 'Leisure Time' and disposable income continues to expand globally.

Latest news:

And one more exciting new stock purchase just made.

In addition we initiated a stock position in the payments space in Europe which continues to represent one of the key megatrends® in the portfolio. The payments sector is an unchanged long term structural growth story. There are several secular growth drivers for the industry that include the shift from cash-based payments to non-cash payments as well as the shift from stationary retail to e-commerce retail. We will share the 'who' it is and 'why' in the next quarterly update.

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