

Melville Douglas

Global Equity Fund

History Rhymes

Our thoughts are with all those suffering in many ways during this very difficult time. Our hope and belief is that, while the situation may well get worse before it gets better, it will pass.

We, humanity, are remarkably resilient. Throughout time, we have endured hardship, but have also emerged stronger, more connected and more resilient. Horrific diseases have been with us from the beginning of time. When there is no cure, self-isolation is the only means to stem the unintended consequence of our desire to physically interact.

Today there are sad parallels with the past. The northern Italian city-state of Venice, one of the medieval world's great trading nations, lived and thrived with this trade-off.

Indeed, the word quarantine stems from the Venetian phrase "quaranta giorni", or 40 days. It was an early form of self-isolation where ships were required to stay offshore for over a month before allowing potentially infected passengers to step ashore during the Bubonic plague era.

The past months have seen the emergence of two global crises – a health one and an economic one. Immense pressure has been placed on health care systems, irrespective of how sophisticated and well-equipped they are across the world. The necessary lockdowns to "flatten the curve" have resulted in the global economy shutting shop and slumping financial markets that threaten a deep recession.

Everything has been done at light speed. The decisions taken by governments and policy makers in days or even hours would have usually taken years to resolve and implement. Many short term, temporary choices will become permanent. The nature of such emergencies is that they accelerate change which ends up becoming a part of everyday life. We are still being screened at airports two decades on from the 9/11 terrorist attacks.

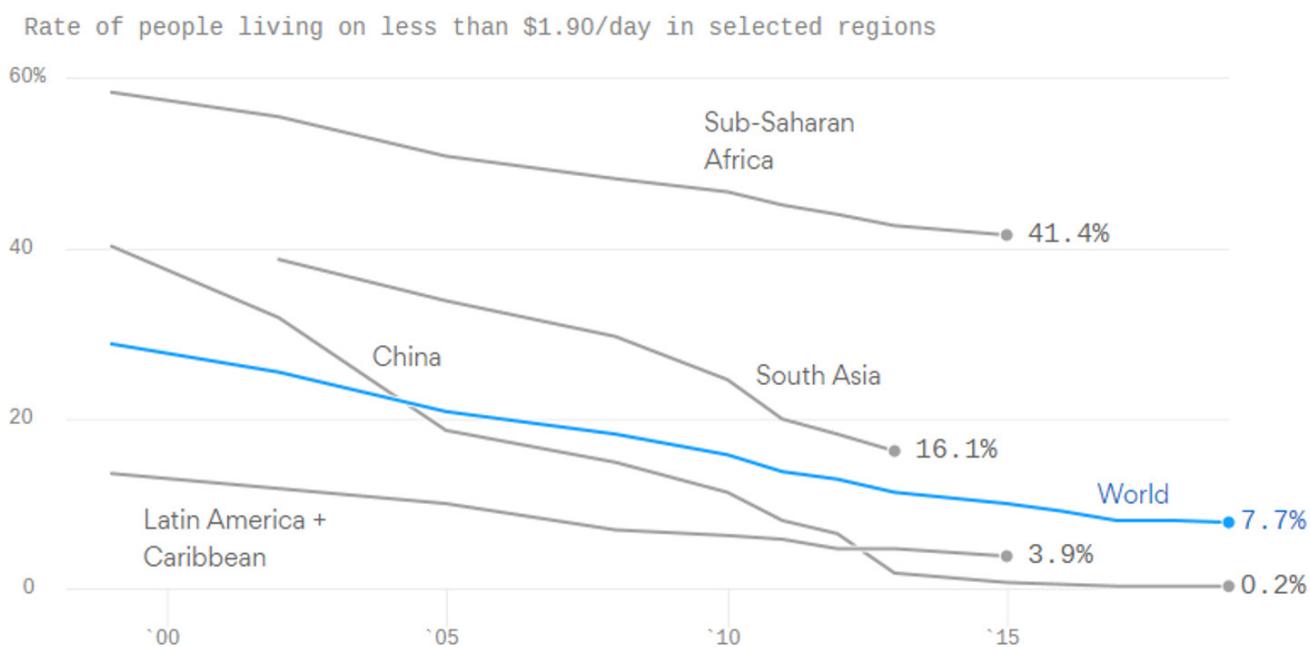
Governments have piled on debts, unlimited money is being printed, many people have lost their jobs and citizens have lost liberties previously taken for granted. We have already witnessed a change in people's behaviours and habits as we go about our day-to-day lives.

Notwithstanding the severity of the here-and-now of the dual health and economic crises - nor the long-term consequences - we are living in a far better place than at any time in history. This past decade alone has seen incredible improvements to our overall well-being as a highly adaptable and thriving society. In his book *Factfulness*, Hans Rosling discusses the great strides we have taken as a society to improve our lives. The central thesis is that in most measures of human development, the world is much better than we think.

Take for example that levels of extreme poverty – characterised as people living on less than \$1.90/day - have halved over the past 10 years. Global life expectancy has increased by three years in the space of a decade. And child mortality rates are down by a third over the past 10 years thanks to technology, education and economic development.

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Extreme Poverty has Halved in the Last 10 Years



Data: The World Bank and World Poverty Clock. Note: 1999-2015 World bank figures are incomplete in South Asia. 2016-2019 figures are World Poverty Clock projections. Chart: Danielle Alberti/Axios.

That is no consolation to the loved ones of those who have died or who remain in poverty, but it does aim to put into perspective the tremendous advancements we have encountered along the way.

As governments, economies and individuals adapt to survive, we will become more creative in ensuring we remain connected despite the invisible barrier placed between us. New ways of working, socialising, greeting and shopping will take root – and from this new companies will emerge, whilst others will become obsolete. The world thrives on resilience and connectedness, and it is this connected resilience that allows every generation to move forward and better its predecessor's lot.

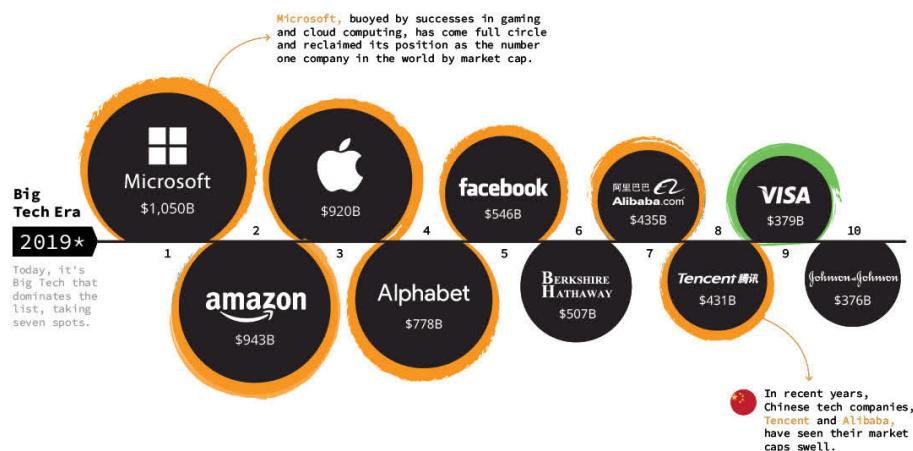
From our Fund Manager's Desk

We regularly explore the investment rationale of one of the companies we own in the Fund, to articulate what we find compelling. This time round we have chosen Tencent.

Founded in 1998 by Pony Ma, Tencent has grown from being a small internet company in China to becoming one of the top 10 most valuable companies in the world. The company's sustainable growth over the years, combined with the protective moat it has built around its empire is what piqued our interest.

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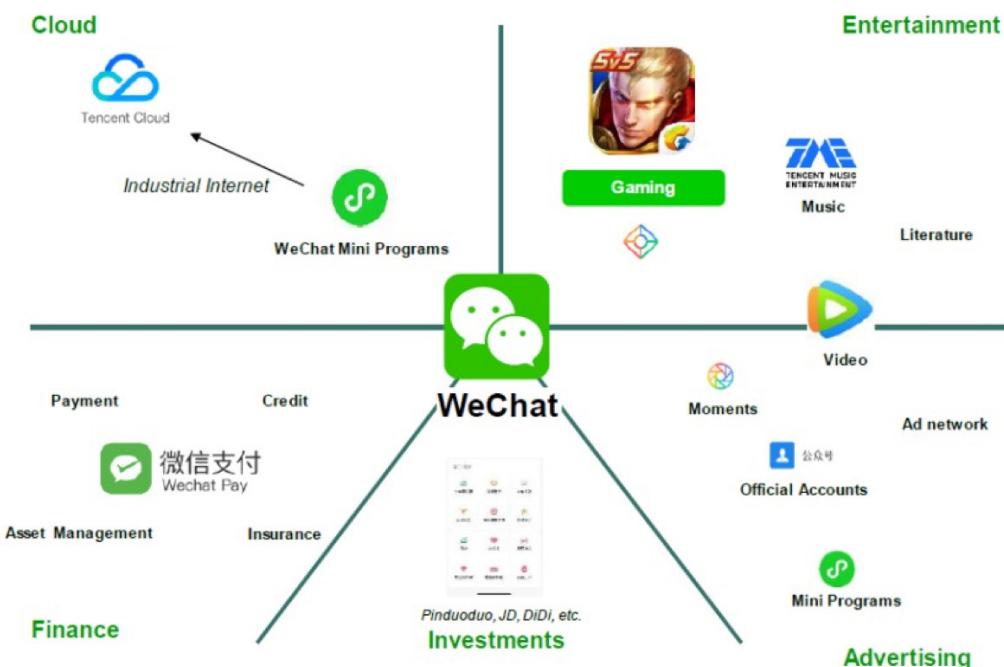
Largest Companies by Market Capitalisation



Source: Visual Capitalist

1.2 billion is a large number. It is the number of active users on WeChat, Tencent's core platform that diverts traffic across a wide range of services from messaging, to entrainment, to payments, gaming and more recently, WeChat Enterprise and Cloud. From the onset, Tencent recognised the importance of user acquisition: instead of developing a product that would be sold to customers at a fee, the company looked to shore up as many users upfront by offering a free messaging and social networking service. The stickiness of its WeChat social media service has been key to its success as it has allowed Tencent to strengthen its core platform through the network effect – a situation in which a product or service becomes more valuable as more people use it.

WeChat is at the Centre of Tencent's Core, Driving its Strategy



Source: Tencent, Bernstein analysis

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By leveraging the network effect, Tencent captures more than 50% of Chinese users' online time spent through its WeChat platform, making it indispensable in day-to-day life. WeChat combines several services under one roof – imagine having access to Facebook, WhatsApp, Spotify, Apple Pay, YouTube, Uber, Amazon and Deliveroo all bundled in a single app. That is the power of Tencent's WeChat platform. WeChat users can message their friends and family, read the news, play games, share interesting images from their travels, shop online, order take-aways and make payments. With more than 45 billion messages being exchanged daily, Tencent benefits from having access to reams of consumer preferences and data. Hungry corporates have noticed the attractiveness of this sticky network base and the billions of eyeballs it attracts.

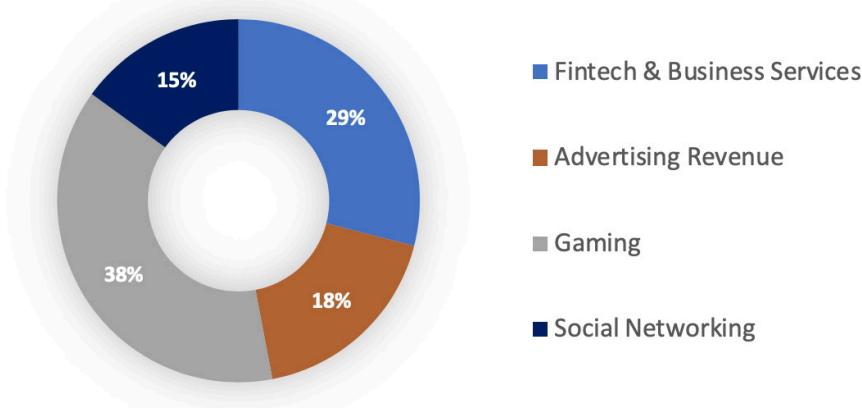
Communication and connectedness are integral to the Chinese consumer's psyche. That is why many companies, both local and international, use official WeChat accounts to market, communicate and advertise their products to the highly attractive Chinese consumer base. This is a relatively low-cost method to promote brand awareness, connect with your customers and grow your followers. Despite the gold-mine that Tencent is sitting on, given the high traffic that passes through its platforms daily, the company only generates 18% of revenue from online advertising. This compares to Facebook – the world's largest online advertising platform – that generates 98% of revenues from digital advertising.

Though Tencent could easily increase its advertising revenues from current levels, the company has actively chosen not to do so in the interest of promoting superior user experience – striking a fine balance between monetisation and quality user experience. After all, it is the users that are the foundation of this business model.

Outside of advertising, Tencent has a huge video gaming offering that commands the lion's share of the Chinese market. Moreover, the company has made considerable progress in diversifying into the international gaming market - the recent consolidation of Supercell has allowed Tencent to gain access to five of the top 10 games worldwide in terms of daily active use. Though the outlook for gaming and advertising look strong, greater opportunities lie in the faster growing services such as cloud computing and payments. This will assist in tilting the business mix in favour of subscription revenues that will enhance the stability of the business model by improving the underlying earnings visibility, as in the case of the cloud business.

Tencent's Diversified Revenue Mix

Tencent's Revenue Mix 2019



Source: Company data

Innovation has been instrumental in shaping Tencent's ecosystem to ensure it thrives and progresses inline with industry changes. The recent lifestyle changes placed upon us as a result of economies adapting to the threat of the COVID-19 crisis has further accelerated the adoption of new behavioural routines. WeChat Work is used by enterprises to facilitate remote communication not only internally with employees but also with customers. The app has the added benefit of integrating into other third-party

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apps such as customer relationship management, human resources and accounting systems to allow for an end-to-end wholistic user experience. This is highly beneficial to corporates who have had to ensure smooth transitioning in shifting workloads online. The company also flagged a boost in activity on their digital healthcare platform as millions of Chinese users made use of the video capabilities to reach out to doctors and healthcare professionals.

As the world's largest gaming company, Tencent's gaming business is expected to benefit from the consequences of social distancing, or rather physical distancing. Both new and existing users have been taking to video games as a way of connecting with people, while engaging in an interactive and social manner. Top grossing games like Honour of Kings, Players Unknown Battleground and Call of Duty Mobile are sure to keep us entertained during this period in isolation. People are innately social, and Tencent's ecosystem is perfectly set-up to facilitate continuity of engagement levels despite the temporary physical barriers that are keeping us apart.

With diversified revenue streams, a sticky user base and attractive monetisation opportunities underpinned by structural growth levers, we see Tencent expanding and strengthening its moat. We back Tencent to constantly innovate and re-invent itself to ensure it remains essential in its users lives. On this basis, we view Tencent as a key holding in the Fund that is well positioned to deliver compounding shareholder returns over the long-term.

Stay Strong, Stay Long

Since mid-March policy makers have sought to "do whatever it takes" to stem the threat from the COVID-19 virus on people's livelihoods as well as on their lives. Central banks around the world have opened the taps, flooding their economies with fiscal stimulus policies aimed at supporting both corporates and employees who have seen their earnings power abruptly grind to a halt.

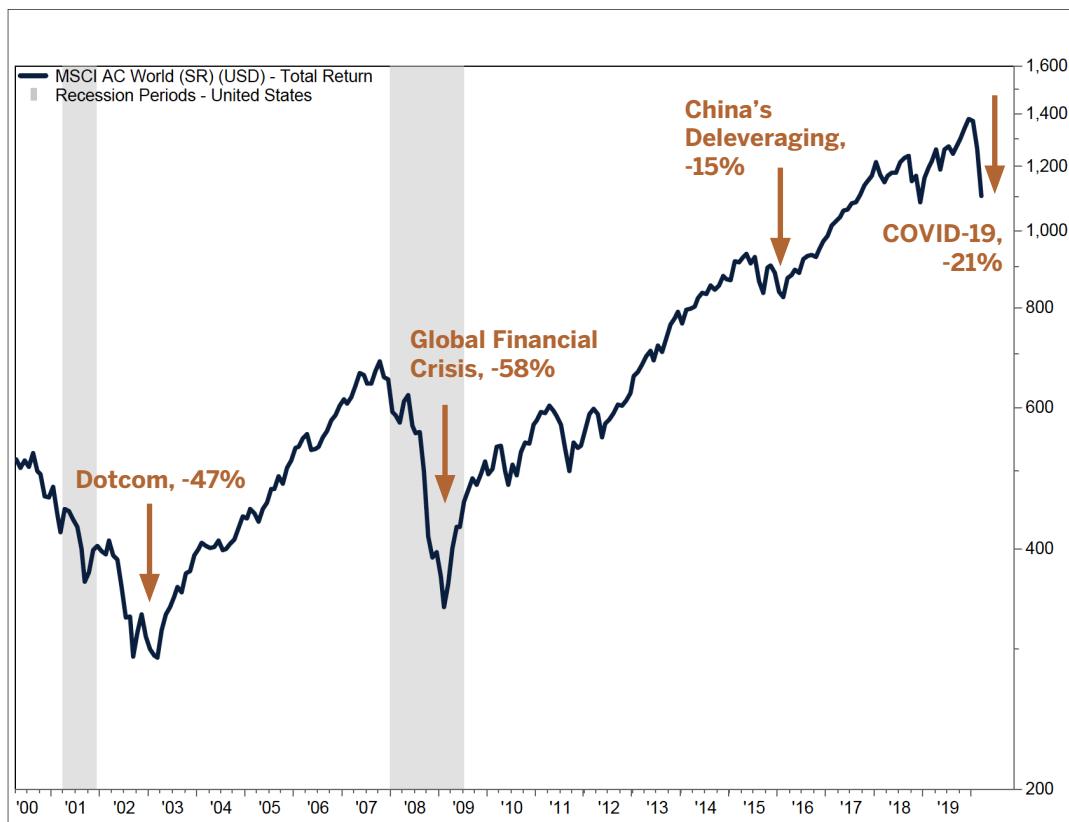
As the first afflicted nation, all eyes are on China. Its equity market sharply corrected in early February as President Xi adopted stricter lockdown measures to try slowdown the rate of growth in infections. Simultaneously, Beijing fired a wide and massive round of policy support to help soften the blow to its economy. While activity levels are gradually recovering, the rebound has not been sharp and rests heavily on the rate of economic recovery across the globe.

The irrational calm initially portrayed by policy makers, governments and investors outside of China instantaneously switched into a rational panic. Global equity markets followed course and the MSCI All Country World Index fell -21% over the first quarter of 2020, with majority of the sell-off taking place in March. Investors in risk-assets bolted at the first sniff of heightened levels of uncertainty. Understandably so, as the global economy enters one of the sharpest, most aggressive recessions since World War II. What makes this recession so unique from other business and economic cycles is that its length will be determined by official and unofficial containment measures rather than monetary or fiscal policy. An economic recovery will be contingent, amongst other factors, on the recovery in the prevalence of the virus.

Markets have become conditioned to accommodative monetary policies that prop markets higher each time. Last year was a case in point. The painful and disruptive downturn currently being felt will turn, and the safety net provided by central banks should provide support to an economic recovery. Market participants will recall that sell-offs like these – as contrarian as it may seem – offer investors an opportunity to build on their long-term returns. It is in these times of maximum fear and uncertainty that strong nerves and utmost focus on the end goal rewards patient investors.

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Global Equity Returns Struggle during Recessions (Grey Shading)



Source: Factset

Recessions are not easy to go through. But they are finite. The virus will be overcome, as history has shown with previous pandemics. But for now - given all the uncertainties - patience and caution continues to be warranted until there is enough evidence that the number of new COVID-19 infections have stabilised, to allow economic activity to resume a more normal path.

Although we have made some adjustments to account for the new environment, our underlying investment philosophy has not changed. We will continue to identify quality compounders that have demonstrated their resilience and ability to weather the storm. Patience and diversification will reap rewards to investors who adopt a longer-term view. We remain committed to managing the Fund with the utmost care and diligence and hope all our clients remain safe during these troubling times.

Melville Douglas

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