NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS GLOBAL EQUITY FUND

Quarter Four, 2019

For the period ended 31 December 2019

NEDGROUP INVESTMENTS GLOBAL EQUITY FUND

Commentary produced in conjunction with Sub-Investment Manager, Veritas Asset Management LLP

AN EXTRAORDINARY YEAR

2019 has been an exceptional year for asset owners with all asset classes delivering large returns. In equities the MSCI World has generated a total return (in USD) of 28% for the year and the S&P 500 has delivered a total return of 31%. Disaggregating the S&P return (where data is most readily accessible), we can see that the bulk of the return has come from valuations expanding rather than from underlying earnings growth. Operating earnings for the S&P 500 were $151.6 in 2018 and are expected to rise only 4% to $158.1 in 2019. The S&P dividend yield adds a further c.1.8% to this 4% so fundamentals would have delivered a return to investors of around 6%. The valuation applied to these earnings though has expanded from a multiple of 16.5x at the end of 2018 to the current 20.5x, a 24% increase. Add this to the 6% fundamental return and you arrive at the 31% delivered by the S&P500 for the year.

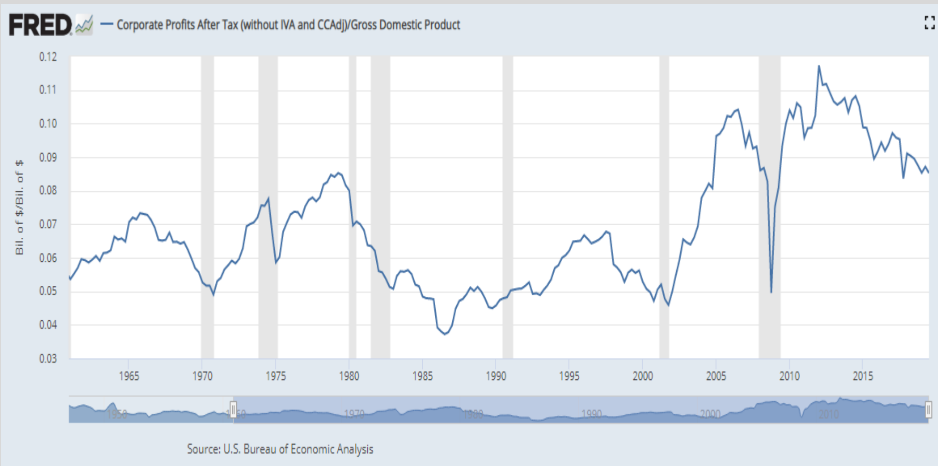
Much as trees cannot grow to the sky, the increase in share prices cannot continually exceed the earnings of the underlying companies. The most that the owners of business in aggregate can get out is what the business earns over time. Individual investors in the stock market may do better than others should they buy at low valuations. Conversely (and necessarily) others will do worse than average as they buy in at high valuations (in fact, it seems that many more investors tend to do worse than the overall averages as they buy AFTER prices have already risen, drawn in by the fear of missing out on "easy" gains).

However, in aggregate investors over time will only be able to earn (at best) what the underlying businesses that make up the stock market earn. Having just experienced a year that has delivered very strong returns to equities, where does that leave us today? In simple terms there are only a few factors we need to know to assess the long-term return of equities going forward:

- Nominal GDP growth
- After tax profits as a percentage of GDP
- Dividend Yield
- Interest rates (Interest rates and increasingly other actions of monetary policies such as Quantitative Easing)

Nominal GDP growth can be considered as a proxy for sales growth across the economy. Since the global financial crisis world nominal GDP growth (measured in USD) has averaged only slightly above 4% so if we assume (generously) that the economy can continue growing at this level without a major recession we start with an assumption for equity returns of c.4%.

After tax profit as a percentage of GDP is basically the margin that companies in aggregate earn on their sales. The data here is hard to get globally but we have good data for the US (see chart below) which shows that profit margins in the US rose reasonably consistently from 2000 to around 2012 since which time they have been broadly flat to down.



It seems likely that over time, there is a cap on profit margins both as a result of competition and if this is not sufficient through public policy. If anything, we would seem to be entering a period where public policy becomes the primary tool that lowers margins but regardless, the likelihood is that margins will be more likely flat or down than rising further from here in which case our assumption for equity returns going forward remains 4% or less.

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Dividend yield can be added to our assumption of "earnings" growth. The yield on the MSCI World is around 2.3% so adding this to our 4% sales growth (and flat margins) gives around 6% return on equities.

Finally, interest rates dictate the valuation multiple that should be applied to earnings. This is because the rates of return that investors need from an investment is directly linked to the risk-free rate that they could earn from government securities. If a risk free 10-year government bond guarantees the holder 6% per year then all other investments (that must carry more risk) need to be considered in the context of this risk-free 6%.

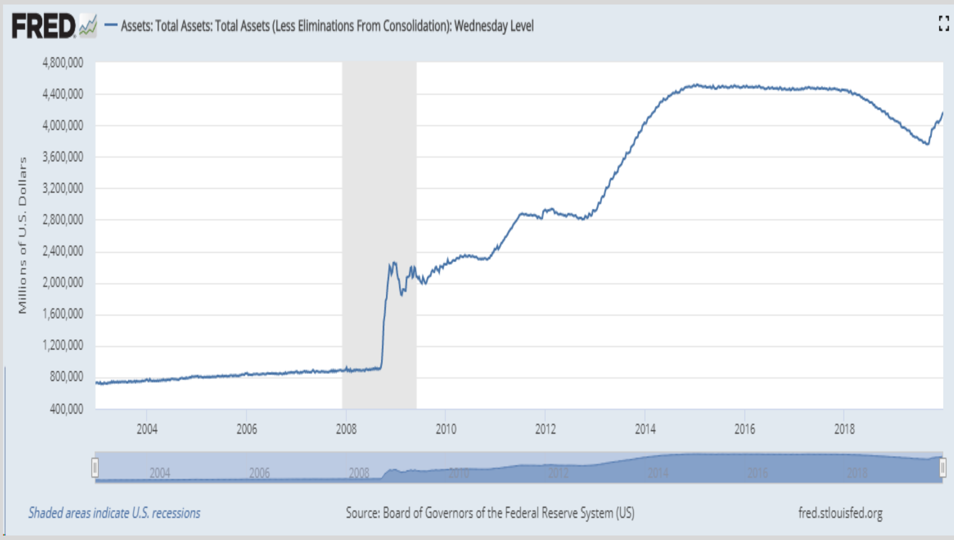
Consequently, as government rates fall, the valuation of all other assets must adjust upwards and if government rates rise then the valuation of all other assets must adjust downwards.

Interest rates today are at generationally low levels. This partly explains the returns delivered in 2019 with interest rates globally falling from their (already) low levels at the end of 2018. The current yields for 10-year generic government securities in the four main currencies are +1.9% (USD); -0.2% (EUR); +0.8% (GBP) and 0.0% (YEN). While it is certainly possible for these interest rates to decline further (note the negative 10-year yield on German bunds) the room for further declines seems more modest than the potential for higher interest rates in the future. This is particularly the case in a world where inflation, while low, is still positive and running between 1% and 2% in most major economies. As a long-term investor one needs to make a judgement as to where government yields are likely to be over your investment horizon. If you invest for 10 years and believe that government rates will be 6% in 10 years' time, the rise in rates will be a significant drag on the performance of equities over that time span reducing the c.6% return we arrived at earlier.

There is at least one additional factor that should also be considered before concluding on the outlook for equities going forward: Quantitative Easing (QE). It is very difficult to quantify the impact of QE on interest rates and therefore its impact on the valuation of assets in general.

The theory is that QE (effectively the government buying securities and not neutralising these purchases) reduces interest rates and forces yield hungry investors into other assets (real assets, equities etc) which then pushes the price of these assets up (with the expectation by central bankers that some of these gains will then be spent in the real economy).

The practical evidence of the impact of QE on equities is very compelling. The chart below shows the total assets of the US Federal Reserve banks. Eyeballing this chart shows that the Fed's balance sheet was broadly flat at around $800bn prior to the start of QE in 2008, at which point it ballooned, rising to over $4.4 trillion by 2015.



If we compare the 11-year period since QE started in the US (2008 – 2019) to the 11 years prior to QE (1997 – 2008) it certainly appears as though QE has been highly successful (if it is measured by the increase in wealth created from rising asset prices):

Year end	10 year US Treasury yield	US GDP (nominal)	Growth in US GDP (11 year)	S&P500 value	Growth in S&P500 (11 year)
1997	5.7%	$8.6trn	n/a	970.4	n/a
2008	2.2%	$14.7trn	+71%	903.3	-7%
2019	1.9%	c.$21trn	+43%	3150	+249%

Source: Bloomberg

As can be seen, in many ways 1997 to 2008 was an economically successful period with nominal GDP growth over the 11 years of 71% and with interest rates declining markedly. However, the S&P500 over this period delivered a negative return (although the total return was slightly positive including dividends). In the 11 years post the GFC and with the benefit of QE, nominal GDP has risen only 43% in the 11 years, interest rates have declined a small amount more, but the equity market has risen 2.5x (pre dividends).

So where does this leave our expectation for equity returns going forward. Absent more QE, then it would seem 6% annually over the long term is nearer a ceiling than a floor. A more conservative investor might argue that margins will erode slightly from current high levels and interest rates will rise somewhat and act as a drag on valuation levels giving a return nearer 3% (and that is before frictional costs!). Clearly a major recession or other exogenous event could result in materially worse returns. However, it seems the most likely outcome from here would be mid-single digit returns – if investors in aggregate expect more than this then it needs to be explained by way of global GDP growth, post tax margin, interest rates (plus QE?) and dividend yield. So, enjoy the returns that asset markets have delivered in 2019 but do not base future expectations on a continuation of these returns.

2019 REVIEW OF HOLDINGS

Four of the largest contributors and four of the largest detractors still held in the portfolio (and therefore still relevant) are detailed below.

Charter Communications

2019 was the year that Charter both started to exhibit the amount of free cash flow that the company can generate and investors began to understand that the threat from 5G to Charter's broadband offering is likely to be fairly insignificant:

Free Cash Flow (FCF) generation: Following the merger of Charter and Time Warner Cable, new Charter has been investing heavily in upgrading both the cable infrastructure (fibre and co-axial cable) and their customer premise equipment (largely set top boxes for cable TV and Wi-Fi modems / routers for broadband). This heavy level of capital spending has depressed free cash flow generation for the past few years. The bulk of this spending is now completed, and Charter's management have indicated their confidence in the capital intensity of Charter declining substantially over coming years. This will lead to significantly higher free cash flow. We estimate that in 2022, Charter will deliver $40 - $45 per share of free cash flow (the spread depends on how many shares the company buys back) which represents a FCF yield of c.8-9% and largely explains why Charter continues to be a major position in the fund.

5G: The concern of investors over the threat of 5G wireless technology competing with cable broadband has declined due to both technology limitations and economics. While 5G broadband works, it has numerous technology limitations that will limit its deployment as a fixed wireless broadband service (for example propagation distance, line of sight requirement, in home wiring requirements etc). However, perhaps more important are the economic issues: the cost of deploying 5G is relatively high and requires scarce and valuable mobile spectrum. Currently spectrum is used in high value offerings (mobile) where typically a user will pay a monthly fee of c.$50 and use on average less than 10Gb of data (so a price of c.$5 per Gb). The typical home broadband user c.400Gb a month of data for around the same $50 price so is paying only

$0.125 per Gb of data. Using valuable wireless spectrum to deliver home broadband seems uneconomic on this basis and could quickly undermine the economics of the mobile phone companies' base business.

Facebook

Facebook entered 2019 with three major concerns; growth deceleration, costs of platform maintenance/policing and regulation. The stock was driven by strong fundamental performance with the first 2 concerns being largely allayed. To illustrate the resilience, in the first nine months of the year the company achieved 27.5% revenue growth and is on track for c.26% for the full year vs 22.5% expected at the outset. Costs have risen markedly, but these have also been significantly less than guided and Zuckerberg has spoken to cost growth being more aligned to revenue growth going forward. Regulation, admittedly, remains a key unresolved issue and headwind to a more significant rerating of the stock.

Going forward, we remain positive on Facebook because 2.7bn users engage with it monthly, engagement remains strong (monthly average users (MAUs) grew 8% year-on-year in Q3 2019), advertisers still have strong intent and finally, we believe that barriers to entry are rising in the industry. In terms of opportunities, Stories is currently under-monetised and has been a headwind but this should reverse over time. Additionally, loss-making WhatsApp is currently a drag on valuation as the loss (c.10% of operating profit) is capitalised in valuations but in reality, WhatsApp is likely to have meaningful value. Furthermore, the ecommerce opportunity around Instagram could be significant and it has been cited as such by the likes of Adidas. Regulation is clearly likely to increase but we believe that some of the more draconian measures will be extremely difficult to pass and are without real historical precedent. They also potentially provide suboptimal outcomes for consumers. Notwithstanding this we believe that the regulatory risk is already being significantly factored into the rating (20x ex-cash 2020 PE) whilst there are still significant monetisation opportunities for the company.

Microsoft

The performance of Microsoft has been driven by strong execution across all major business segments and improving perception of the company's positioning in public cloud with Azure. Satya Nadella's execution has been excellent and has led the company to 14% revenue growth in their 2019 fiscal year. This was driven largely organically by the move to subscription, greater resilience of 'legacy' products and Azure. The company has also generated operating leverage through diligent cost management and scaling the businesses, contributing Earnings Before Interest and Taxes (EBIT) growth of 22%. This is particularly impressive given the scale of the business ($125bn in revenues in 2019).

We continue to hold Microsoft because we believe that it is in a sweet spot of execution that has been long in the making and will be persistent. This should continue to drive double digit revenue growth and higher operating profit growth over the medium term. The most compelling aspect of the business is that as digitisation occurs Microsoft is uniquely positioned with its hybrid offering (cloud/on-premise).

The transition towards subscription continues and the cloud businesses have grown in the mix which should also bolster the mid-term growth. Finally, Azure remains a significant opportunity in the medium to long term. To put into context, Azure is one of the two leaders in the public cloud market with AWS. Gartner predicts the public cloud services market will be worth just under $400bn by 2023 vs Azure estimated revenues of c.$14bn in fiscal 2019 so the scope here remains significant and operating margins can be attractive (20%+ EBIT margins) noting AWS disclosures. Given these factors, the business remains one the most attractively placed globally in the long term.

Airbus

Airbus is another long-term holding that exhibited strong execution in 2019. The company has been gradually introducing the updated version of its most popular aircraft, the single aisle Airbus A320 family. During 2019 the new version (A320 New Engine Option or A320neo) has seen production ramp up such that in the month of November 55 of 56 Airbus A320's delivered were of the new A320neo version. The ramp up in production of such a technical product with long supply chains is well known as being high risk with multiple opportunities for serious issues to arise. During 2019 Airbus have successfully managed all production issue that arose as they have increased capacity which removes a significant risk to the company and its investors.

During 2019 Airbus also successfully negotiated the change of the top management team with both the CEO and CFO being replaced. The new CEO, Guillaume Faury is a long-standing Airbus employee who worked closely with the previous and highly successful CEO, Tom Enders. The new CFO, Dominik Assam, joins as an experienced CFO from German semi-conductor company Infineon Technologies AG. Having met both we believe that the transition from the previous management to the new management has been executed well and that new management have the requisite skills to drive the company forward.

Airbus remains a highly cash generative company and with no major new aircraft families on the horizon, development expenditure will remain subdued for some time to come which will enhance cash generation. It seems likely that the company will need to return some of this excess cash to shareholders over the next few years.

Svenska Handelsbanken

Since investing in Handelsbanken around a year ago its share price has been broadly flat, underperforming the rising market. There are several reasons explaining this underperformance, most of which are now pointing in the right direction, and so we are confident that our investment in Handelsbanken will realise its value.

Its lending margin has been weaker than expected, meaning that net interest income (being the bulk of total revenue) has grown more slowly than robust lending volume. Handelsbanken was charging higher rates than its peers, meaning it was (1) more vulnerable to stiff competition and (2) unable to exploit an improving context and raise pricing (unlike its peers) with higher domestic interest rates. However, there is no longer a pricing gap between any of the banks and so net interest income should now grow more strongly. Meanwhile, its non-lending revenues continue to post strong growth.

Handelsbanken is already an efficient bank. Over the past year, however, heightened investments have meant that expenses have grown faster than revenues. Like other banks, this largely reflects investment in upgrading compliance systems (although it has navigated compliant growth expertly unlike others), but it also seems that Handelsbanken had underinvested in digital technology to serve customers more cheaply. Its new CEO, although a bank veteran, has taken decisive steps to mitigate these investments by exiting fringe products and countries to improve efficiencies and, from 2020 onwards, we should start to see the benefits of these cost actions, which should have a leveraged effect with improving revenue growth. Nor did Handelsbanken make a provision to its LT profit-sharing scheme last year (no bonuses at Handelsbanken) meaning that employees share the burden with shareholders.

We like the Swedish FSA being a prudent regulator. It is front-loading many capital surcharges on the Swedish banks today that other global banks shall face in the future. Handelsbanken is penalised on a relative basis by carrying more capital than its strong track record merits. Last year had the headwind of uncertainty surrounding charges on commercial real estate lending, although this was recently resolved and, although more penal than expected, is manageable without threatening either growth or indeed its dividend and we can move on. It is likely that these uncertainties pass to other banks around the world.

Handelsbanken has many attractive characteristics. The quality of its lending book is outstanding because it focuses on profitability and not volumes. When the industry moves into a credit downturn, the market is likely to put a premium on Handelsbanken's more stable earnings and book value. As it outperforms other banks, this is likely to reinforce its funding advantage and its stronger options to choose profitable growth. In the meantime, we expect a stronger signature in both revenues and expenses and for its ROE and valuation premium to be realised.

Rolls-Royce

Rolls-Royce was purchased a number of years ago, during a period of distress for the company as they embarked on a transformation journey under a new management team (led by CEO Warren East). Even within the context of the unpredictable trajectory of transformation programs, the company has had a very difficult 2019 with continued challenges in one of their engine programs (the Trent 1000 which is an engine option on the Boeing 787) which has caused significant customer disruption as well as adverse cash drain. To put the issue into perspective, the company will spend £2.4 billion in cash towards both engineering fixes (in progress) as well as customer remediation and penalties – this represents almost 20% of the current market capitalisation. The scale and severity of these engine issues have resulted in other notable achievements being overshadowed - like the smooth and reliable entry of the XWB engine (which is exclusive to the Airbus A350) as well as meaningful operational improvements elsewhere. From a financial perspective, given the optimisation of operations and the supply chain, working capital movements (notably reduced inventory which benefits cash flows) and the pre-payment of revenues for 'flying hour contracts' continue to be viewed sceptically by the market with currency volatility (arising from Brexit) an added detractor for the shares. The net impact of all the various moving parts has been that reported free cash flow continues to have a severe adverse impact and this has deferred the realisation of underlying earnings potential further than we had anticipated at the time of our purchase.

Reckitt Benckiser

2019 has been a difficult year for the company: a new CEO at the helm (Laxman Narasimhan), along with a new CFO (Jeff Carr), and a strategic review slated to be presented in February 2020. Coincidentally (but not unrelatedly), operating performance has been a disappointment (organic growth rate slowing to 1.6% in aggregate in the last reported quarter (Q3 '19) – which compares unfavourably to growth rates of their end-markets closer to 4-5%) – this is at least somewhat related to the change of guard and the strategic review of their segments which has been an operational overhang for the company. The company also had to deal with a disruption to one of their manufacturing facilities in the Netherlands (which sells into the infant nutrition market in China – a key segment) and a legal settlement costing $1.5B (arising from their previously owned and spun-off subsidiary Indivior). The aggregate effect has been disappointing.

Looking forward, one of the crucial debates in the company (and more widely across consumer staples) is the trajectory of margins and the level of reinvestment needed to maintain brand equity and vitality – this is expected to be addressed by the incoming management team in early 2020.

There is no obvious piece of evidence that suggests RB have under-invested into their brand equity (their spend relative to revenues remains at the top end of the peer group), but given some of the multiple unrelated issues we have seen at the company, it is possible that they have to invest into productivity measures and better systems. Having reviewed our thesis, we continue to judge RB's underlying assets in consumer health and household/personal care as being well-positioned and underperforming due to poor execution and focus. We remain agnostic as to whether their two major segments are kept unified (or spun off or sold) as it doesn't alter our estimate of value - it is apparent the segments are now being run with greater autonomy and agility anyway (for example, their Hygiene-Home segment has delivered above-market organic growth). With the appropriate focus on commercial execution, organic growth rates are likely to improve meaningfully over the next 5+ years. A new management team who have communicated a return to 'simplicity and focus' (who notably accepted remuneration terms prior to joining, with no incentive to 'kitchen sink') is perhaps just the dose of self-help the company needs at this juncture.

Cigna

The poor performance of Cigna Corp shares in 2019 was largely due to the market's perceived risk of Medicare For All (M4A) becoming a reality in the US. Cigna is primarily a health insurance service company to US corporates and health plans and, were there to be a viable government health insurance system with broad coverage for all, Cigna's role would be hugely compromised. When Elizabeth Warren, as a leading Democratic Nomination candidate at the time, and other leading Democrats loudly supported a new M4A bill in February 2019, health insurance stocks declined strongly, with Cigna leading the decline. By contrast, UnitedHealth Group and CVS Health have more diversified revenue streams.

Other factors contributing to Cigna's weakness in 2019 included fears of higher medical cost trends which would impair the margins of health insurers, however, these concerns were proven unfounded by Q3 19 industry earnings results. An additional specific factor for Cigna was the execution of the integration of Express Scripts, a leading pharmacy benefit manager, and market fears in general about the political focus on US drug pricing and consequent potential deleterious regulatory pressures on pharmacy benefit managers. By the year end, however, Q3 19 operating results had assuaged investors' concerns regarding integration risks, strong free cash flow generation continues, and the political risk to pharmacy benefit managers had receded (at least for now).

The greatest risk to Cigna then remains M4A and as the prediction markets and polls started to report lessening support for Elizabeth Warren in Q4 2019, health insurance stocks rallied.

It is of interest that this turning point in Warren's popularity coincided with the moment she attempted to outline how Medicare for All could be funded; pushed as she was to prove she has 'a plan for everything'. Higher taxes for many and lack of choice in a government mandated health plan are unattractive to the majority of voters. The market moved strongly in support for the US health insurers but there remains a risk. Elizabeth Warren is still in the top four candidates for the Democratic Nomination and more popular than her now in the aggregate polls and prediction markets is Bernie Sanders, the original architect of a Medicare for All policy. However, as we have communicated before, our analysis suggests the probability of M4A becoming US law in the foreseeable future is below 2%. Briefly, this is based upon affordability (Sanders plan would cost $40trn over 10 years) and the politics of passing legislation in the US. In order to be able to pass the legislation required for M4A, a left-wing Democratic Nominee would need to win the presidency, retain control of Congress and win a 60-seat super majority in the Senate. Much more likely and possible to legislate, for either party, would be a combination of an expansion of existing Government programmes together with implementing some schemes to reduce the out of pocket expenses suffered by patients. Such an outcome would be positive for insurers insofar as it expands the population of those insured.

Until there is resolution of the Democratic Nomination, and should Warren or Sanders win, the Presidential Election, the health insurers share prices will likely remain volatile. This is to be expected: if taking on such a risk (even if small) were easy and quickly resolved then the opportunity would not arise in the first place. The risk is mitigated to some degree by ensuring the portfolio exposure to health insurers is limited and balanced within the context of the whole portfolio.

Longer Term Perspective

As indicated earlier, 2019 has been a spectacular year for equity investors with the MSCI World (in USD) generating a return of 28% for the year. Despite this very rapid appreciation, the portfolio managed to keep pace with the rise despite having a large average cash balance and holding (in our view) higher quality, lower risk holdings.

ATTRIBUTION COMMENTS FOR Q4 2019

The portfolio was relatively flat over the quarter versus the MSCI performance indicator. Given the average cash weighting over the period was high, this was one of the main detractors given the rise in markets. As investors are aware, the weight in cash fell substantially at the end of 2018 with the market correction but has steadily increased again throughout 2019 as markets have risen and a number of positions have been sold. This has meant an overall return for the year slightly above the benchmark despite a high cash weighting and substantial absolute gains from markets. Looking specifically at Q4, the main contributors to performance came from a continuation of rising returns from Charter Communications and Facebook and improvements from earlier in the year from the US health insurers; United Health and Cigna, and also from Svenska Handlesbanken, Canadian Pacific Railway and Capita. The detractors, with the exception of Rolls-Royce (discussed in the Portfolio Manager's essay), were stocks that have performed well over the year, including Unilever, Nestlé, Safran and Baxter International, with cash being the main detractor. Taking the stocks in turn:

Charter Communications

Charter has performed well over 2019 as explained in detail within the Portfolio Manager's report. Over the quarter, the company reported better than expected earnings report and attracted broker upgrades. Increasingly, brokers are buying into the thesis that the company remains well-positioned to benefit from increased penetration rates in broadband, and an overall mix shift to higher margin 'growth business'. The company reported third quarter earnings that included an increase of 310,000 customers. Revenue increased by 5%. Charter is the second largest cable business in the US but has opportunities to improve margins (currently its margins are below its peers) as it continues to integrate Time Warner Cable and Brighthouse Networks and they enter the harvest phase of those acquisitions.

Investors' concerns about slowing economic growth, the trade war, and tumbling bond yields in 2019 have made US cable companies' domestically-focused and recession resistant business models attractive.

Facebook

Facebook performed well on better than expected revenue (+29% year-on-year) and Earnings Per Share. The number of daily average users was up 9% and monthly average users up 8%. Approximately 2.2bn people now use one of Facebook's platforms.

Svenska Handlesbanken

Svenska is placed into the longer-term perspective in the PM essay. Over the quarter, the bank announced it was to cut 800 jobs and pull out of Asia and Germany as it exits inefficient products and countries and focusses on costs. Handlesbanken has not been embroiled in Baltic money laundering scandals that have engulfed Nordic rivals as it has a history and governance structure that focuses on profitability and not volumes. The position has been built up over the year as we focus over the next 5 years.

UnitedHealth and Cigna

As described above, the US health insurers have risen sharply over the last quarter after Senator Elizabeth Warren's recently released Medicare for All plan was being viewed as more moderate and favourable to health care insurers. The plan tacitly acknowledges the high political hurdles to passing Medicare for All. Operationally, the companies are performing well. UnitedHealth's third quarter earnings were above expectations (with a 6.7% increase on 2018) and they raised profit guidance for the year.

Capita

Capita provides IT and technology-based outsourcing services to a number of government bodies and large companies. It is in the midst of a five-year turnaround plan under CEO Jon Lewis who took over in 2018. Lewis has reduced debt and refocussed operations and the stock received a boost after the UK election result given it relies heavily on public contracts and a political impasse has been lifted. The company, which runs contracts for the British Army and the NHS, has continued to win contracts, such as London Borough of Bexley and the Ministry of Defence. The position was trimmed on strength.

Canadian Pacific Railway

Canadian Pacific Railway (CP) is the second largest Class 1 railroad in Canada and implemented Precision Scheduled Railroading, a more efficient point to point network (a little like a passenger train) and moved away from a 'hub and spoke' model (cars enter a hub or terminal and then reshuffled to different trains, often requiring numerous redirects before finding their ultimate destination). Canadian Pacific transports everything from bulk goods (e.g. grain) to cars and finished goods. Given that many of their customers own the containers that are transported (approx. cost of $100K per container) and the efficiency of the network has led to up to 25% quicker journey times, both fixed capital (amount of containers that need to be owned) and working capital (less product in transit) are freed up and Canadian Pacific can increase prices by 3-4% p.a. The company announced it was confident in delivering promised full-year double digit Earnings Per Share growth despite slower volume growth in the second half of the year. The unchanged profit forecast stands in contrast to rival Canadian National Railway. CP is buying Central Maine and Quebec Railway which owns 774 km of rail lines in Quebec and Maine. Ironically, it used to own the line but sold it in 1994 and it has had three owners since, two of which have subsequently gone bankrupt. The rationale for CP buying is the company sees big opportunities in using the line to become a true transcontinental railway by giving it a new link to Port of Saint John, currently undergoing a $200m expansion of its container capacity. With the proven success of the precision scheduled railroading operating model coupled with increased port access, the acquisition makes sense. Not only does the company believe it can improve operations and drive more volume along the railway, but it is reflecting on the belief that world trading patterns may be changing.

While it makes sense to move containers to North America through west coast ports if they are coming from China, if manufacturing moves to India and Vietnam, the shortest sailing distance to North America ends up being through the Suez Canal. That makes East Coast ports a lot more desirable. Nobody is building new rail lines as its simply too expensive, time consuming and, in today's world likely to be environmentally challenged (barriers to entry).

Unilever

Unilever was one of the consumer staples companies bought in 2018. The company has performed well since purchase and the position was trimmed during 2019. The developed markets are tough and are structurally such that dominant players will have to run to stand still for the foreseeable future. It's for this reason we favour Emerging Market centric businesses and Unilever in particular. Unilever, over the quarter, announced it now expects FY 2019 estimated underlying sales to fall below the low end of its guided range of 3-5%, the implication being a 1-1.5% growth rate in Q419. "Earnings, margin and cash are not expected to be impacted," and the company is investing appropriately in its brands and R&D. There is also a multiyear line of sight on sufficient costs savings to continue to support sales growth without impairing margins.

Underperformance has been particularly pronounced in developed markets where the company has identified hot spots for attention: US hair, ice-cream and dressings. While the company pointed to incremental improvement vs Q3 in these hotspots, there was insufficient improvement to offset 'macro' affects in South Asia which has slowed from low teens growth a year ago to below 5% today (particularly rural India). Growth is expected to incrementally improve in H1 20 and accelerate in H2 20 such that FY20 will be at the low end of the 3-5% multi-year target. We see nothing to be overly concerned with here although we should be alive to the fact that it may take longer to return to above market growth than they expect. Unilever may move further toward simplifying the business in the way that Nestlé has done successfully. At ~4.3% cash earnings yield, 3-5% long run sales growth, and limited margin progression, Unilever is fairly valued today. Given its defensive qualities we would not reduce the position until we can find superior risk reward elsewhere.

Nestlé

Nestlé's sales figures for the first nine months of the 2019 fiscal year were generally favourable. Total reported sales climbed 2.9% to 68.4 billion Swiss francs. Organic growth was even stronger, coming in at 3.7%.

Geographically, Nestlé got most of its sales lift from the Americas segment. There, reported sales jumped 9.5%, with 5.5 percentage points of that number coming from merger and acquisition activity. However, even taking that into account, organic growth exceeded 4%. Nestlé pointed to extremely strong performance for the Purina pet food and products segment as bolstering performance, and the launch of Starbucks branded creamer to complement its coffee offerings helped generate excitement as well. However, China was weaker than expected. The company has been simplifying its business, and recently sold its skin health division. It also plans to split up its water business and integrate it into its three geographical zones from this year. The company also announced plans to make massive distributions of capital back to its investors. Between 2020 and 2022, Nestlé's board agreed to distribute as much as 20 billion Swiss francs to shareholders. The food giant will keep paying regular dividends, but it also anticipates doing stock buybacks as well as paying out special dividends as occasions warrant.

Baxter International

Baxter International provides a broad portfolio of essential renal and hospital products, including acute and chronic dialysis; sterile IV solutions; infusion systems and devices; parenteral nutrition therapies; premixed and oncolytic injectables; biosurgery products and anaesthetics; drug reconstitution systems etc. The company products are used by hospitals, kidney dialysis centres, nursing homes, rehabilitation centres, doctor's offices and by patients at home under physician supervision. The company has performed extremely well but fell 12% during the last quarter after it announced preliminary third-quarter 2019 operating results. The business expects to report quarterly revenue of $2.85 billion and operating income of $503 million, but that relatively strong performance was overshadowed by two other developments. First, the company disclosed that an internal investigation was underway related to misstatements in foreign currency gains dating back to 2014. The audit doesn't concern product-related operations. Second, Baxter International disclosed that it has been named in a complaint by Fayette County, Georgia, alleging that an injectable opiate product previously manufactured by the company caused harm to the county. Baxter International used an incorrect exchange rate when calculating the impact of foreign currency transactions. The business posted total foreign exchange gains of $294 million from 2014 through June 2019. It never reported a foreign exchange loss in that period.

While the concern sparked by the need to restate financials is understandable, the core matter here relates to non-operating income and thus looks fairly benign. Additionally, Baxter stopped manufacturing injectable opiate products in 2011, so whilst there are some risks associated with further claims, it’s unlikely the company will be subjected to the worst of the opioid-related lawsuits. At the time of writing the stock price has recovered to pre-fall levels.

Safran

The aero-engine manufacturer has performed extremely well since purchase. During the quarter, its rise was halted by the ripple effect of the Boeing decision to suspend production of the grounded 737 Max aircraft after the Federal Aviation Administration said it would not approve the planes return to service before 2020. Safran produce the engines.

Relative attribution by region: 3 months to 31 December 2019

	Portfolio			Index			Relative Attribution Analysis		
Region	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Allocation Effect	Selection Effect	Total Effect
Asia/Pacific Ex Japan	3.1	6.8	0.2	4.0	5.8	0.2	0.0	0.0	0.1
Japan	–	–	–	8.3	7.6	0.6	0.1	–	0.1
North America	54.4	13.1	7.0	66.5	8.8	5.8	-0.0	2.2	2.2
United Kingdom	11.9	6.3	0.8	5.4	10.0	0.5	0.1	-0.4	-0.3
Europe ex UK	18.7	4.2	0.8	15.5	8.5	1.3	-0.0	-0.8	-0.8
Africa/Middle East	–	–	–	0.2	7.2	0.0	0.0	–	0.0
Cash and equivalents	12.0	n/a	0.1	–	–	–	-0.9	–	-0.9
Total	**100.0**	**8.8**	**8.8**	**100.0**	**8.6**	**8.6**	**-0.8**	**1.0**	**0.2**

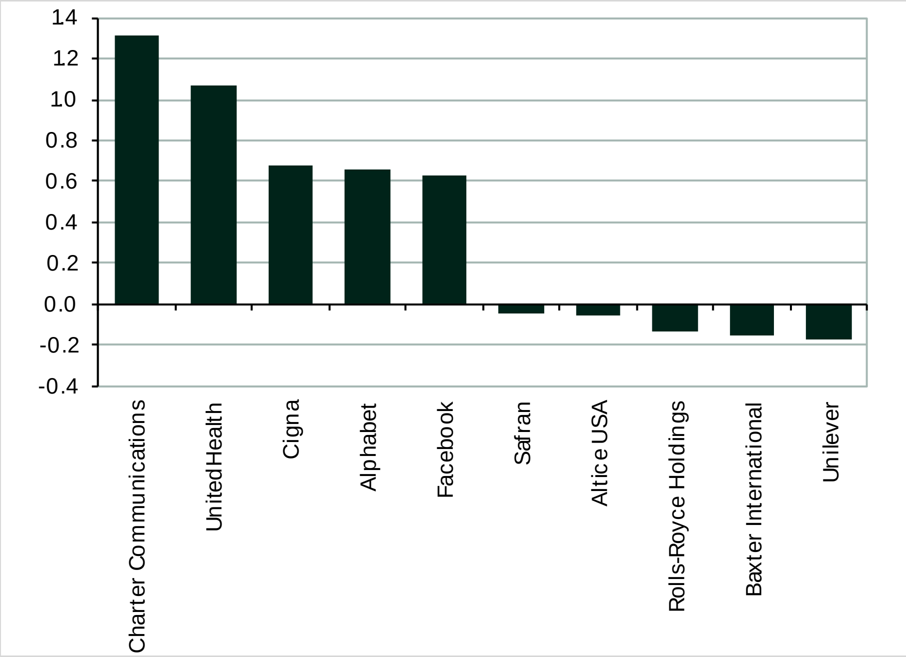
Relative attribution by sector: 3 months to 31 December 2019

	Portfolio			Index			Relative Attribution Analysis		
Sector	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Allocation Effect	Selection Effect	Total Effect
Consumer Discretionary	–	–	–	10.4	6.7	0.7	0.2	–	0.2
Consumer Staples	13.0	2.6	0.3	8.5	2.6	0.2	-0.3	0.0	-0.3
Energy	–	–	–	5.0	5.0	0.2	0.2	–	0.2
Financials	7.8	9.9	0.8	15.7	8.7	1.4	0.0	0.1	0.1
Health Care	22.6	14.0	3.0	12.7	13.7	1.7	0.5	0.1	0.5
Industrials	20.5	7.8	1.6	11.2	7.4	0.8	-0.1	0.1	-0.0
Information Technology	3.2	13.7	0.4	16.9	14.0	2.3	-0.7	-0.0	-0.7
Materials	–	–	–	4.4	8.6	0.4	-0.0	–	-0.0
Communication Services	20.9	12.1	2.5	8.5	8.1	0.7	-0.1	0.8	0.7
Utilities	–	–	–	3.4	2.0	0.1	0.2	–	0.2
Real Estate	–	–	–	3.3	1.2	0.0	0.2	–	0.2
Cash and equivalents	12.0	n/a	0.1	–	–	–	-0.9	–	-0.9
Total	**100.0**	**8.8**	**8.8**	**100.0**	**8.6**	**8.6**	**-0.8**	**1.0**	**0.2**

Relative attribution by security: 3 months to 31 December 2019

	Portfolio			Index			Attribution
Holding	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Total Effect
Top 5 relative stock contributors							
UnitedHealth	3.4	35.6	11	0.6	35.6	0.2	0.6
Charter Communications	7.7	17.7	13	0.2	17.7	0.0	0.6
Cigna	2.2	34.7	0.7	0.2	34.7	0.0	0.4
Capita	17	21.5	0.4	–	–	–	0.2
Canadian Pacific Railway	3.1	14.8	0.5	–	–	–	0.2
Bottom 5 relative stock contributors							
Unilever	4.4	-3.7	-0.2	0.2	-3.7	-0.0	-0.5
Baxter International	2.9	-4.2	-0.2	0.1	-4.2	-0.0	-0.4
Rolls-Royce Holdings	19	-6.6	-0.1	0.0	-6.7	-0.0	-0.3
Safran	2.7	-19	0.0	0.1	-19	-0.0	-0.3
IntercontinentalExchange	2.3	0.5	0.0	0.1	0.5	0.0	-0.2

Key stocks driving portfolio results



COMMENTARY ON TWO SIGNIFICANT STOCKS IN YOUR PORTFOLIO

Charter Communications

+17.7% in USD

(Communication Services, United States)

Charter Q3 results indicated that the thesis remains on track - continued growth in highly profitable broadband subscribers with moderate losses of marginally profitable TV subscribers leads to growing operating profit while at the same time, declining capital investment requirements results in rapidly growing free cash flow. While the results were broadly in line with expectations, the number of new subscribers positively surprised.

Unilever

-3.7% in USD

(Consumer Staples, Netherlands)

Unilever disappointed the market in December by announcing that full year revenue growth would fall below the low end of their guided 3-5% range with the implication being a 1-1.5% growth rate in the final quarter of the year. The company pointed to an unexpected slowdown in South Asia, and rural India specifically, a result of broad based consumer weakness as opposed to any company specific issue. South Asia will remain a major growth driver for Unilever for many years to come, and while the rate of growth is not immune to cyclical weakness, we do not think this is a cause for particular concern for the patient investor.

Portfolio breakdown: As at 31 December 2019

Region	Portfolio %
North America	54.1
United Kingdom	15.4
Europe ex UK	15.3
Asia Pacific ex Japan	3.0
Cash and equivalents	12.2
Total	**100.0**

Sector	Portfolio %
Health Care	23.6
Communication Services	21.5
Industrials	20.5
Consumer Staples	12.8
Financials	5.9
Information Technology	3.4
Cash and equivalents	12.2
Total	**100.0**

Currency	Portfolio %
USD	66.3
EUR	13.6
GBP	11.2
SEK	3.7
AUD	3.0
CHF	2.1
CAD	0.0
Total	**100.0**

Top 10 portfolio holdings: As at 31 December 2019

Holding	Sector	Country	Portfolio %
Charter Communications	Communication Services	United States	7.9
Alphabet	Communication Services	United States	6.8
BAE Systems	Industrials	United Kingdom	5.0
Thermo Fisher Scientific	Health Care	United States	4.7
Facebook	Communication Services	United States	4.4
Unilever	Consumer Staples	United Kingdom	4.2
Airbus	Industrials	France	3.8
UnitedHealth	Health Care	United States	3.8
Svenska Handelsbanken	Financials	Sweden	3.7
Reckitt Benckiser	Consumer Staples	United Kingdom	3.5
Total			**47.9**

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UK investors should read the Appendix for UK Investors in conjunction with the Fund's Prospectus which are available from the Investment Manager. www.nedgroupinvestments.com

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