




see money differently

A photograph of an open book with white pages, tied with a white string bookmark. The book is positioned on the left side of the page, with the pages fanning out towards the right.

## **Nedgroup Investments Global Equity Fund**

Quarter Three, 2020

## 1. Market Overview and Outlook

### Portfolio Manager Commentary

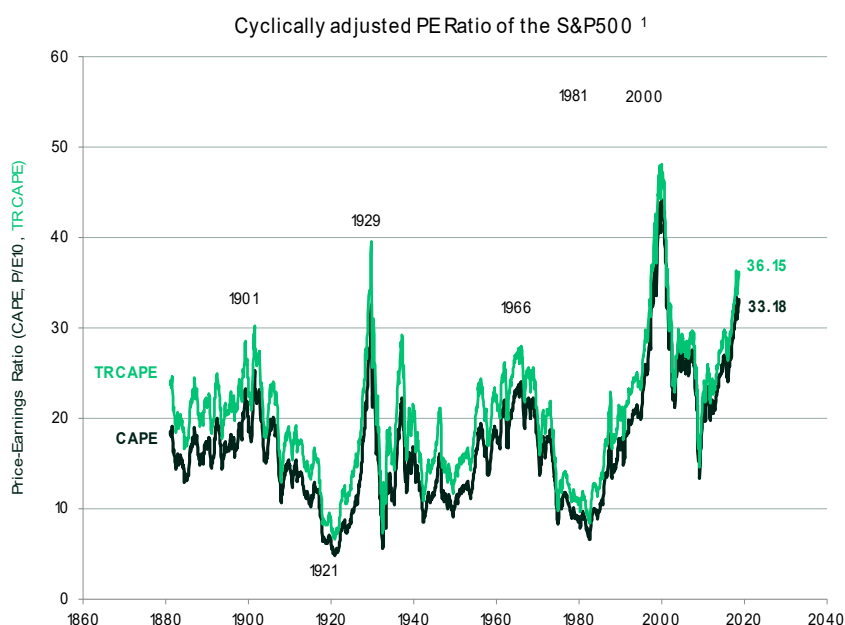
#### Déjà vu

After nine months of 2020, the MSCI World index is up 1.70% in USD. In most scenarios, this return would seem somewhat lacklustre but if someone had told you on New Year's Eve 2019 that the world would suffer a global pandemic with over one million recorded deaths and economies shuttered a positive return would seem remarkable. This is perhaps even more the case given we have not yet emerged on the other side of the pandemic. While hopes for a vaccine remain high, at this juncture there is no cure for COVID-19 and many more are sadly likely to die before a vaccine is approved and administered to enough people to engender herd immunity. Why then are financial markets taking such a benign view?

While this question is impossible to fully answer I would venture that “animal spirits” (also known as “Fear Of Missing Out” or FOMO) are a major part of the reason that markets have responded so benignly. With zero-percent interest rates, zero-cost stock trading, zero-percent bank reserve requirements, record setting money growth and time on their hands, more “investors” are participating in the stock markets of the world. By some accounts retail investors now account for around 25% of all trading on the New York Stock Exchange (up from around 10% last year) and in South Korea, day traders accounted for 87.5% of the total value of Korean equity trading in the first eight days of September. The consequence of this is not just a generalised rise in valuations (although this has occurred as illustrated by the nearby chart of the cyclically adjusted PE ratio of the S&P500) but perhaps more worryingly a concentration in the type of investment that retail investors and day traders prefer.

In general, day traders are focused on the price momentum of a position – buying those ones that are rising the most and selling short those that are falling the most. Typically, these companies have a wonderful story (platform or network companies in the software/cloud/electric vehicle/alternative energy industries are common themes). In general retail investors and day traders are not concerned with long-term value: their aim is to get in for the ride and sell before the decline.

Another phenomenon in recent years has been the influx of (semi) passive investing with the development of exchange traded funds (ETFs) and the industry that promotes them. Such passive investment vehicles buy a specified set of companies, typically sizing positions in proportion to the market capitalisation of the companies but with no regard to valuation. The promoters of ETFs want them to be popular so tend to include those companies/stocks that are doing well – perhaps no surprise that Microsoft (up 33% in 2020) is in 674 different ETFs!



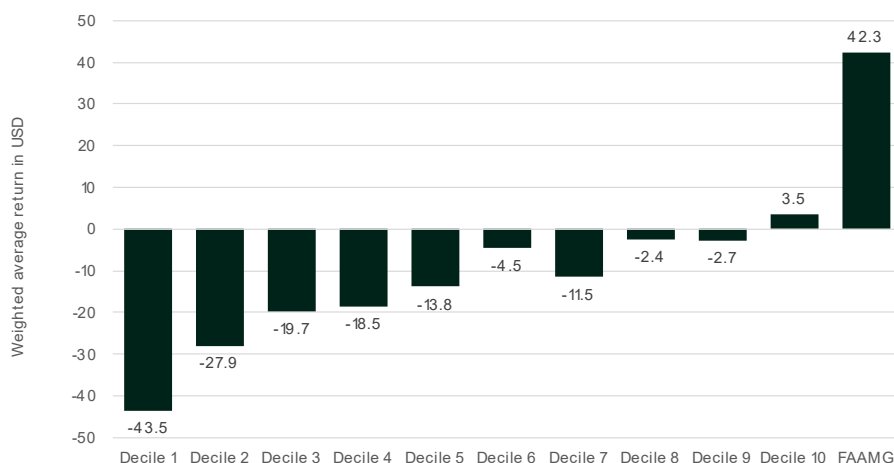
<sup>1</sup> Source: <http://www.econ.yale.edu/~shiller/data.htm>

Consequently, both day traders and passive vehicles are valuation agnostic: not for them the concern as to what level of free cash flow yield, Price Earnings ratio or another metric is acceptable or attractive. The result of this is that for as long as the flows of retail investors and ETFs bear significant weight on the markets, valuations can be distorted from reality. Evidence of this comes from the share price movements around recent high-profile corporate actions in Apple and Tesla: on 31 July Apple announced they would split their stock in a 4/1 stock split. Remember, a stock split has no effect on the overall value of the company, it simply turns one share into four new ones (each in theory worth 25% of the old one) – after the event you own the same proportion of the company as you did before. However, in the five trading days after Apple's announcement the shares increased by 17.5% and added a whopping \$291bn to Apple's market cap. Not to be outdone on 11 August Tesla announced a 5/1 stock split. In the subsequent five trading days, Tesla added an incredible 37% and \$96bn in value. This is not Investing as Ben Graham would have understood it.

If we disaggregate the performance of the equity market so far in 2020 it quickly becomes clear that a small number of companies have been responsible for the bulk of performance. These companies are the large cap technology companies that are a favourite of both day traders and ETF promoters. Facebook, Apple, Amazon, Microsoft and Google (Alphabet) (FAAMG) collectively account for c.14% of the MSCI World at the end of September 2020. These five companies have added \$1.8trn in market capitalisation this year alone which represents almost 4% of the entire MSCI World index. In other words, these five companies have delivered more than 2x the total return of the MSCI World in the year to date. In effect this means that the remaining c.1,600 companies that constitute the MSCI World in aggregate delivered a negative total return of around 2%. In the following chart we have plotted the average return of the MSCI World constituents, split into size decile at the start of the year (10 deciles) but excluding the FAAMG group which are shown separately.

The results are stark – returns improve with size and all deciles except the very largest companies have generated negative returns. The FAAMG group on the other hand have generated a weighted average return in 2020 of +42.3%, considerably better than the median company in the MSCI World (in USD) with a total return of -8.0%.

MSCI World returns by market cap decile <sup>1</sup>  
9 months to 30 September 2020



<sup>1</sup> Weighted average total returns in USD. Deciles based on market caps at beginning of period. Decile 10 excludes FAAMG (Facebook, Apple, Amazon, Microsoft, Google). Source: FactSet, MSCI, Veritas Asset Management

In a momentum driven value-agnostic environment it seems the only thing to own are large cap tech stocks. With the markets focus firmly on the mega cap tech stocks, owning companies that are considered to be “value” has not been particularly rewarding. The performance of growth relative to value (see chart) has reached extremes not even seen during the 1999 / 2000 tech bubble. With a disciplined approach to valuation, we at Veritas gravitate towards those companies that appear to offer value in relation to the free cash flow that they generate. These are not typically the high growth momentum companies favoured by ETF promoters/buyers

and day traders. Historically however, valuation has always reasserted itself. The more distorted the differential between growth and value becomes the more aggressive has been the move back when it finally comes. Unfortunately, the timing is something we do not know and as the famed investor Howard Marks once quipped “Being too far ahead of your time is indistinguishable from being wrong”. We therefore work hard to identify high quality investments that can grow at a reasonable rate at the same time as being attractively valued.

MSCI World Value index relative to MSCI World Growth Index <sup>1</sup>




<sup>1</sup> Source: MSCI, Bloomberg. Chart rebased to 100 at inception

## Implications for the portfolio

Despite the continuing rise of tech, we have continued to search for quality, cash generative companies with strong and durable competitive advantages that we believe can compound up over a number of years. In this regard, we have initiated a new position in Fiserv. This is a company we know well, having invested in its shares back in 2014. Looking back and being honest with ourselves, we sold too soon. Nonetheless we maintained coverage and analysis of this excellent company that has changed profoundly over this time, waiting for an opportunity to invest once more at an appropriate valuation with margin of safety. To these ends, we have watched its share price underperform over recent months and we have considered the reasons for its share price weakness – our judgment led us to conclude that the market was penalising its valuation too heavily and so we took the opportunity to invest.

Fiserv is a very attractive company embedded deeply within the (largely US) payment and financial service industries. It offers critical services to its customers. Fiserv handles day-to-day account processing for its banking customers, as well as a multitude of payment offerings that allow its customers to process transactions across traditional, new and emerging payment rails. Its recent acquisition of First Data means that it is now also a leading merchant acquirer, determining and settling transactions between all types of merchant and cardholders through the payment networks. These are all excellent parts of the global financial infrastructure that have high barriers to entry and enduring business models.

Fiserv is a prime beneficiary of banks needing to improve IT, as well as the fast-moving digitalisation of payments; the strong structural shift from cash to electronic transactions. In fact, the current pandemic is accelerating this shift, with both remote eCommerce payments and proximate contactless payments showing strong and durable outsized growth. Many companies and commentators expect the Covid-19 boost to digitalisation to persist, as greater digital adoption is habit forming – which is all to the good for our investments in Mastercard, Alibaba, Facebook and now Fiserv but even if old habits are re-established, digitalisation remains a supportive and enduring long-term trend.



Fiserv is a strong quality compounding business. It has market leadership and a deep embedded relationship with its customers. This strong industry positioning means it benefits from both economies of scale (size) and scope (products) that allow it to grow market share by offering best-of-breed products on a bundled basis. This offers benefits to customers – lower overall costs, while speeding up time to market without compromising on product capability and effectiveness. This means Fiserv enjoys high-quality recurring revenue growth with almost pristine retention rates, minimising customer acquisition costs. Like other network businesses with low marginal operating costs, its growth is not especially capital intensive, has very strong operating leverage and, with dependable compounding of earnings, this leads to high cash conversion to support a premium valuation rating – that it does not carry at the current time.

However, while revenue growth is both steady and resilient, Fiserv has only posted growth in the mid-single digit percentage range, which compares unfavourably to other tech stocks (even though Earnings Per Share growth has been consistently double digit). In large part, this explains why Fiserv participated in the consolidation of the merchant acquiring segment through its purchase of First Data last year. We believe this is a decent acquisition and early progress is positive. It complements the existing legacy business, and this is proved through the cross selling of products from one legacy business to the other. While merchant acquiring no doubt adds more transactional revenues, these grow faster over the cycle. They are also ad valorem and so provide some protection from expected inflation, as well as exposure to the spending recovery that is underway in domestic markets. While First Data is tilted to more traditional merchants and less so to eCommerce, it nevertheless has an attractive portfolio of faster-growing assets, including Clover that is a competitor to market darling Square.

There are several reasons explaining its recent share price underperformance. Nonetheless, we believe these factors will prove to be ephemeral, although some sooner than others. Jeff Yabuki (old Fiserv CEO) has stepped down and has been replaced by Frank Bisignano, who headed First Data. Because the market rates Yabuki highly, it is concerned about the CEO transition and has marked its shares down.

We rate Yabuki too, but we believe Bisignano is exactly the right CEO for Fiserv right now. He has a strong track record in executing complicated acquisitions, particularly his responsibility for both the Bear Stearns and Washington Mutual transactions, whilst at JPMorgan during the global financial crisis. Back to Fiserv and Bisignano has in fact raised the deal synergies he expects to achieve, yet the market consensus remains dubious over these, even though the company is already delivering speedy progress. We believe Bisignano shall deliver, especially since most of the synergies relate to costs and the total extent of these is not out of kilter with those achieved in similar acquisitions. Chances are these are even increased again, as overlap remains between Fiserv and First Data that is not being tackled right now, for instance the two separate debit PIN networks operated by each legacy company. By underestimating Bisignano, the market is misjudging operating leverage and free cash flow generation, that we hope to exploit by investing now. At the very least, we believe this provides ballast to downside protection.

Like other merchant acquirers, as well as the card networks, First Data's revenues have been vulnerable to COVID. However, the timely Visa and Mastercard operational data show domestic transactional recovery is underway, boding well for First Data of course. Even in the downturn, First Data proved in aggregate to be more resilient than most of its peers, thanks to its low exposure to travel that continues to remain very weak. However, the market seems to have focused on its lower exposure to eCommerce and marked other companies up. While this is no doubt true, it is not entirely absent. Nor is First Data without other high-growth areas: Bisignano showed his strategic dexterity by purchasing Clover (mobile point-of-sale system) where payment volumes are now bigger than at Square and growing faster (Square has a market cap of \$75bn – the whole of Fiserv is \$70bn – one of those numbers is wrong!).

We believe operating leverage will prove stronger than others expect. Its Investor Day in December is likely to crystallise further evidence of progress and recovery. Not least, we believe First Data has late-cycle recovery potential though its traditional bricks and mortar merchant customer base.

Because First Data was in private equity ownership, its large debt load crowded out investment, although Bisignano straightened out investment and strategic assets. That said, leverage of the combined group is high

but strong cash generation means is manageable and leverage reduces quickly. The remaining negative is the residual overhang of Fiserv share capital owned by the private company but as long-term shareholders, we can look through that although that is clearly unwelcome.

Fiserv's prospective PE of 20x is at a local minimum and below its average of the past five years. It trades on a prospective free cash flow yield of almost 6%, with Free Cash Flow expected to grow mid-teens, which is a very attractive combination and leads to an estimated IRR of over +15%. We believe that our model has a balance between being realistic but conservative and so there is margin of safety in our assumptions, as well as in the overall defensive nature of its cashflows.

## 2. Fund performance contributors & detractors for past quarter

### Top 5 contributors and bottom 5 detractors

Holding	Portfolio			Index			Attribution
	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Total Effect
Top 5 relative stock contributors							
Charter Communications	8.3	22.5	1.7	0.2	22.4	0.0	1.0
Alibaba Group	3.6	36.3	1.1	–	–	–	0.8
Canadian Pacific Railway	3.9	19.4	0.7	–	–	–	0.4
Thermo Fisher Scientific	3.2	21.7	0.6	0.4	21.9	0.1	0.3
The Cooper Companies	3.0	19.0	0.5	0.0	18.9	0.0	0.3
Bottom 5 relative stock contributors							
Svenska Handelsbanken	3.5	-11.3	-0.4	0.0	-11.3	-0.0	-0.6
Baxter International	4.1	-6.5	-0.3	0.1	-6.4	-0.0	-0.6
Cigna	2.0	-14.2	-0.3	0.1	-9.7	-0.0	-0.5
CVS Health	2.9	-9.6	-0.3	0.2	-9.6	-0.0	-0.5
Safran	4.8	-1.6	-0.2	0.1	-1.2	-0.0	-0.5

### Attribution by Sector

Sector	Portfolio			Index			Relative Attribution Analysis		
	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Allocation Effect	Selection Effect	Total Effect
Consumer Discretionary	3.6	36.3	1.1	11.5	16.0	1.7	-0.6	0.6	0.0
Consumer Staples	10.7	10.5	1.1	8.2	7.5	0.6	-0.0	0.3	0.3
Energy	–	–	–	2.9	-16.0	-0.5	0.7	–	0.7
Financials	7.1	-1.0	-0.0	12.4	1.8	0.3	0.3	-0.2	0.1
Health Care	30.8	5.8	1.8	13.8	4.8	0.7	-0.5	0.3	-0.3
Industrials	22.3	3.7	0.5	10.2	11.7	1.1	0.4	-1.9	-1.4
Information Technology	5.0	10.9	0.5	21.6	11.8	2.5	-0.5	-0.1	-0.7
Materials	–	–	–	4.5	11.7	0.5	-0.1	–	-0.1
Communication Services	18.8	13.8	2.6	8.8	8.2	0.7	0.1	1.0	1.0
Utilities	–	–	–	3.3	4.7	0.2	0.1	–	0.1
Real Estate	–	–	–	2.9	2.1	0.1	0.2	–	0.2
Cash and equivalents	1.7	n/a	-0.0	–	–	–	-0.3	–	-0.3
Total	100.0	7.6	7.6	100.0	7.9	7.9	-0.3	-0.1	-0.4



## Attribution by Region

Region	Portfolio			Index			Relative Attribution Analysis		
	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Allocation Effect	Selection Effect	Total Effect
Asia/Pacific Ex Japan	9.5	21.0	1.8	3.6	2.0	0.1	-0.4	1.6	1.3
Africa/Middle East	—	—	—	0.2	-2.0	-0.0	0.0	—	0.0
Europe ex UK	22.6	1.8	-0.0	15.2	5.9	0.9	-0.2	-1.1	-1.3
Japan	—	—	—	7.8	6.9	0.5	0.1	—	0.1
North America	59.4	9.1	5.4	69.1	9.3	6.4	-0.1	-0.2	-0.4
United Kingdom	6.9	3.8	0.4	4.2	-0.2	0.0	-0.2	0.3	0.1
Cash and equivalents	1.7	n/a	-0.0	—	—	—	-0.3	—	-0.3
Total	100.0	7.6	7.6	100.0	7.9	7.9	-1.0	0.6	-0.4


## Portfolio Attribution Commentary

With no end in sight for the pandemic, 'work from home' stocks continue to benefit. **Charter Communications** shares rose on the back of both the stay-at-home economy, and by the return of live sports, with Major League Baseball beginning its season and the NBA continuing its 2020 season in Florida. More live sports is a positive for video subscribers and for local advertising for Charter, which has seen declines in video subscribers for the past few years as viewers 'cut the cord' and watch more content online. The company see the future in video as offering more of a 'video store', with a whole range of products and services such as tiers of sports channels, advertising Video-On-Demand (VOD) services with other linear TV services. In addition to reversing the video trend, Charter reported Q2 earnings that significantly beat estimates for both revenue and earnings per share. Especially positive was the acceleration of customer net additions, which grew from 221,000 in the same quarter a year ago, to an impressive 842,000 last quarter. The company saw increased interest from some enterprise businesses like hotel and restaurants which have essentially become take-out services dependent on fast broadband.

**Alibaba**, the Chinese leading e-commerce giant is another company that has benefitted from the pandemic crisis, as more people adopt and increase amounts of online shopping and realise the importance of cloud computing. In the recent fiscal quarter, this was reflected in an increase in revenue of 34% year-on-year. Alibaba's core Chinese marketplace held annual active consumers of 742 million and mobile monthly active users of 874 million in June 2020, both more than 2x the total U.S. population. Alibaba will continue to generate most of its revenue from its core commerce and cloud computing businesses in the near to medium term. The company's e-commerce operations, which constitute around 86% of total revenues, have largely higher margins, notably lighter supporting infrastructure, and are less capital intensive. However, Alibaba has become one of the biggest names in the cloud computing market. It is the biggest provider of infrastructure-as-a-service (IaaS) in Asia, and the third largest platform in the world. Significantly, it will become profitable by next year well ahead of previous expectations. Currently, Alibaba makes all its money from e-commerce, with all other businesses losing money.

With Cloud becoming profitable ahead of expectations, this will help power earnings growth. With the numbers of users in China arguably reaching saturation, the company has room to increase its take rate (it charges less than half of what Amazon takes from merchants) and it is expanding into the rest of Asia via its Lazada platform. Its 33% stake in e-payments company Ant Group (Alipay) has just become more valuable with the IPO of Ant looking to raise as much as \$35bn.

Despite economic uncertainties, **Canadian Pacific Railway** produced earnings in excess of expectations, albeit a drop on last year's number. Considering CP operates trains that are up to 2 miles long, they have been nimble in adjusting resource in lockstep with demand. One area has been the introduction of larger hopper cars and longer trains to respond to increase grain demand. These new 8,500-foot High Efficiency Product (HEP) trains can carry in excess of 40% more grain than the older 7,500-foot model as a consequence of the extra length and new hopper cars. The company reported a record quarter for grain shipment. This trend is likely to continue as many customers and ports at the end of the line are investing in new elevator networks in order to



accommodate 8,500-foot HEP trains. The performance of the bulk franchise which includes grain and potash have helped to offset some of the declines experienced elsewhere (e.g. construction related, automotive). The company has increased its dividend for the fifth consecutive year and is closing in on its target of a 25% dividend payout ratio. Canadian Pacific target fuel efficiency and reported a record quarter at 0.92 gallons per 1,000 Gross Ton Mile (GTM) which enabled a record Q2 operating ratio of 57%. They have guided positive earnings growth for 2020 by keeping costs under control one of which is linked to environmental factors (fuel efficiency). Looking ahead, with the completion of the Port of St. John on the East Coast, Canadian Pacific offers the shortest route between the Atlantic coast of Canada and Montreal providing shippers with a compelling service to reach North American markets quickly.

One position that has been on the front line as far as the pandemic is concerned is **Thermo Fisher Scientific**. The company reported a jump in Earnings Per Share of 28% in its Q2 earnings report. The pandemic has brought both headwinds and tailwinds for the company as illustrated by the performance of its four divisions. There was strong performance from the Bioproduction and Pharma services businesses (e.g. drug development and commercial manufacturing) which rose +10%, weaker performance in both Industrial and Applied (e.g. Environmental monitoring, Animal health, food/beverage analysis) which fell 10% and Academic and Government (e.g. providing research tools) which fell 20% and hit by work disruptions and a huge jump in Diagnostic and healthcare (+70%) due to COVID testing. Of the reported \$6.9bn revenue, \$1.3bn was attributed to COVID. Thermo Fisher is involved throughout the pandemic response from providing research tools to personal protective equipment to diagnostics as well as supporting the development and production of therapies and vaccines. The company received approval in March for its TaqPath COVID-19 Combo Kit. It provides tests for 50 countries and ramped up capacity to provide up to 10 million tests per week if needed. There was a shortfall in sample collection materials, the swabs, vials and media needed to collect and transport the specimen to testing lab for processing. The US government turned to the company who ramped up production of highly specialised viral transport media (VTM) to address the need. VTM is critical to ensure the accuracy of COVID test results and must be manufactured and dispensed into vials in an aseptic environment. Thermo Fisher designed and built a new factory in Kansas in six weeks to meet demand. The company is developing further tests e.g. more accurate serological test to determine if the patient has ever been exposed to the virus. The company has not slowed its R&D and focused on the implications of COVID in terms of accelerating build out in Biologics development and Pharmaceutical support. In June, the company launched its two new Orbitrap Explores mass spectrometry machines to help advance biotherapeutic research and won a multiyear contract with the US Biomedical Advanced Research and Development Authority (BARDA) to provide pharma services in support of accelerated vaccine development and production.

**Cooper Companies** reported that they had increased their global market share of the contact lens market to 25%, becoming the second largest global contact lens business in the process. Whilst the revenue numbers for both the contact lens (approx. 75%) and the fertility treatment (approx. 25%) businesses were down, the results were much stronger than expected and better than competitors as the company bounced back from COVID lows. As consumers return to normal wearing habits and social activity picks up, contact lens use has increased. As children return to school, parents are increasingly concerned about screen time and with online education rising, they are proactively addressing their worries by scheduling eye exams. Digital eye strain has seen a marked increase in both children and adults. Cooper's MyDay sphere and toric lenses are seen as premium silicone hydrogel lens which is picking up market share and MiSight (the only FDA approved contact lens for myopia) has had a successful launch. Both help 'cross sell' other products. The Biofinity Energys is a very unique lens using digital zone optics to help alleviate eye fatigue from excessive screen time. It's a perfect fit in today's world and grew strongly in the quarter. With the epidemic in myopia, MiSight is well placed for the future. Over 1000 optometrists in the US are now certified to fit the lens. This new market, which is children aged 8-12 years old, is a \$1.5bn market in the US alone based on conservative estimates. Adding in the rest of the world, including Asia where myopia levels are as high as 80%, the addressable market is \$5bn+. Today, the lens draws revenue of \$1.6m as the company starts to roll out promotional campaigns to better educate on myopia management. As deferred elective procedures steadily reschedule, the Cooper Surgical business (largely fertility treatment) has begun to recover. The company expects to see IVF cycles return to normal in the US and Europe by year end.



Turning to the key detractors over the quarter:


**Svenska Handelsbanken** fell after Sweden's financial watchdog told the bank to change how it calculates risk at its subsidiary in Britain which will increase the amount of capital the bank has to provide for potential losses. Some banks in Europe are allowed by regulators to use their own models to assess the risk of losses in their lending portfolios, while others have to use a standard model set by their country's watchdog. Usually, the standard model is more conservative. Handelsbanken will have to use the standard model from next year.

The Swedish Financial Supervisory Authority has decided that, from 1 January 2021, the bank is also to use the standardised approach at group level, when calculating the capital requirement for credit risk at Handelsbanken Plc. The risk exposure amount at the bank will consequently increase by approximately 65 billion Swedish crowns (£6 billion) in conjunction with the introduction of the new method. The bank's common equity tier 1 ratio remained over the target ratio range following the change. In addition, during the quarter the bank reported significantly lower loan losses than its Nordic and European peers during the pandemic, underlying its lower risk approach and drawing praise from Moody's. Whilst the requirement is not a cause for concern, we are engaging with the company over its decision to introduce annual bonuses. Up until now Svenska has run a profit-sharing plan, the Oktogonen Foundation, and employees have to wait until they are 60 to see any of that money. This reduces the risk that employees will chase short-term gains without considering long term outcomes and largely explains the impressive low percentage of bad loans consistently delivered. We need to understand the terms and rationale for this change.

**Baxter International's** second quarter performance reflects the evolving impact of pandemic conditions on their operations. They reported a year on year decline in both net sales and earnings. While demand for certain pandemic related treatments and technologies reached historic highs within the quarter, the company saw a negative impact on results from significantly lower rates of hospital admissions and a reduction in selective procedures. Approximately 20-30% of COVID-19 ICU patients will develop acute kidney injuries, requiring treatment with a renal replacement therapy, of which continuous renal replacement therapy (CRRT) is the preferred option. Baxter are a leader in this area and their Renal business is also seeing growth in peritoneal dialysis therapies and Sharesource telehealth technology (where patients can be monitored virtually) as clinicians and patients look to home-based treatment to limit the risk of potential pandemic exposure. Offsetting this positive news was negative impact on the Medication Delivery, Pharmaceuticals and Advanced Surgery businesses.

There has been a 20%+ decline in US hospital admissions and a reduction in US surgical volumes of more than 30%. A similar trend was seen in Europe and Latin America. There was however improvement in Asia and especially China, reflecting the direction of travel once lockdowns subside.

Whilst in the case of Baxter, investors are not looking through to normalisation, that appeared to be the case with two other names within healthcare. Cigna exceeded earnings expectations helped by lower medical costs from delayed surgeries and robust sales in its pharmacy benefits business (the Express Scripts business it bought). As Americans delayed non-essential surgeries and avoided hospital visits, healthcare spending costs declined, benefiting health insurers. The performance of the shares is based on the company guiding for increased costs in the second half of the year as people begin to catch up on delayed procedures. Cigna's medical care ratio, which compares expenses for medical claims with income from premiums, improved significantly during the quarter to 70.5% from 81.6% a year earlier. Sales in the company's health services segment, including the pharmacy benefit manager (PBM) arm, rose 22% largely driven by a jump in pharmacy script volumes. Earnings per share (EPS) came in at \$5.81 per share against a forecasted \$5.15 per share. The other concern amongst investors is the extent of attrition from commercial membership given the impact on the economy from the pandemic. To date, Cigna has seen a very modest decline. The lower insurance enrolment due to unemployment has not affected the company's commercial health care business as much as anticipated. This is largely due to the employer client mix which is less weighted toward industries most affected by the economic upheaval.



Similar to Cigna, **CVS Health** reported a strong second quarter and actually raised its outlook for the year. EPS came in at \$2.64 versus an expected \$1.93 per share. CVS Health has undergone a transformation in becoming a more integrated healthcare provider. Its strategy is to provide care wherever people are - in the community, at home or in the palm of their hand. They have been transforming some of their pharmacy outlets into 'Health Hubs' which can undertake many of the costly but non-critical procedures/examinations traditionally performed in hospital.

During the quarter, at the drugstore chain, front of the store revenue and prescription volume dropped as many customers stayed at home. However, the health benefits business saw operating income rise over 40% compared with a year earlier, with the deferred elective procedures. These trends have started to reverse in calendar Q3. However, one area that is seeing significant early adoption is telemedicine, which jumped 700% during the reporting quarter. Customers are starting to use health care monitoring at home and becoming more comfortable with it. CVS have set up more than 1,800 testing sites at drive through locations and performed more than 2 million tests. Over 40% of those tested were not previous CVS customers. CVS is likely to play a key role in any vaccine administration.

Unsurprisingly, aerospace stocks lagged given concerns of a second wave of coronavirus and the likely effect that further lockdowns would have on the travel industry. Israel announced a second nationwide lockdown during September and other countries have introduced localised lockdowns and other restrictions. **Safran**, which manufactures one of the most sought-after engines to power short haul planes, relies on servicing and parts for the majority of its profitability. The company has clearly been impacted during calendar Q2 but has still guided a 10% operating margin and positive free cash flow in the second half of the year. This relies on a gradual recovery of air traffic so any negative pandemic news will affect short term stock performance. Many of the planes powered by their engines are being sold into Asia which is resuming short haul flights. Safran has over 7,000 CFM engines in service or on order in Greater China. As at the end of June 534 engines had been delivered year to date as opposed to 1,119 in H1 2019. It's likely that short haul tourism will recover first and this plays to both Airbus and Safran.

### 3. Current Positioning

#### Top 10 Portfolio Holdings

Holding	Sector	Country	Portfolio %
Charter Communications	Communication Services	United States	8.1
Alphabet	Communication Services	United States	7.5
Safran	Industrials	France	4.8
Unilever	Consumer Staples	Netherlands	4.5
Mastercard	Information Technology	United States	4.4
BAE Systems	Industrials	United Kingdom	4.4
Canadian Pacific Railway	Industrials	Canada	4.2
Alibaba Group	Consumer Discretionary	China	4.0
UnitedHealth	Health Care	United States	4.0
Baxter International	Health Care	United States	3.9
Total			49.7

#### Portfolio Breakdown

Region	Portfolio %	Sector	Portfolio %	Currency	Portfolio %
North America	60.6	Health Care	30.1	USD	65.5
Europe ex UK	23.8	Industrials	23.1	EUR	18.8
Asia Pacific ex Japan	10.0	Communication Services	18.7	AUD	6.0
United Kingdom	4.7	Consumer Staples	8.8	GBP	4.7
Cash and equivalents	1.0	Information Technology	7.6	SEK	3.0
Total	100.0	Financials	6.7	CHF	2.0
		Consumer Discretionary	4.0	CAD	0.0
		Cash and equivalents	1.0	Total	100.0
		Total	100.0		

Please refer to portfolio commentary under items 1 and 2 for further information on current positioning and outlook.

## 4. Responsible Investment

### Sustainability case study

We look for sustainable businesses run by forward thinking management.

This quarter we focus on CVS Health.

**CVS Health** is a US healthcare company that owns CVS Pharmacy, a retail pharmacy chain, CVS Caremark, a pharmacy benefits manager (helps lower the price of drugs by creating approved drug lists for corporate clients) and Aetna, a health insurer provider.

The company has been undergoing a transformation in an aim to become the most consumer-centric health company. The management is aware of changing consumer needs and adapting accordingly. Earlier this year, the company also launched its 13th annual corporate social responsibility report (CSR) and unveiled Transform Health 2030, its new CSR roadmap for the next decade.

Following a comprehensive materiality assessment conducted in 2019 and in accordance with the Global Reporting Initiative (GRI) Sustainability Reporting Standards which is aligned with the Sustainability Development Goals. (SDGs), the company aims to focus on four main areas:

- Healthy People
- Healthy Business
- Healthy Community
- Healthy Planet

There is a clear link between sustainability and value creation.



### Proxy Voting

As long-term shareholders of equities, we believe in voting on all resolutions. We employ a customised policy which is applied by Institutional Shareholder Services ("ISS") and incorporates the Environmental, Social and Governance ("ESG") Red Lines, developed by the non-profit organisation Association of Member Nominated Trustees ("AMNT"). Whilst we believe in the philosophy behind the ESG Red Lines, they are designed to be applicable to companies within pooled vehicles and only companies domiciled in the UK. As a result, we have signed up ISS to apply a customised screen whereby the Red Lines are applied to UK equities and Global equities on a best endeavours basis. ISS, our third party proxy advisor, provide us with company research and vote recommendations for each meeting resolution based on our blended policy, in addition to providing the vote execution service for the firm. The global investment team will use the research provided alongside their own analysis to determine their vote decision. It is not uncommon for the investment team to have a view which differs to that of our policy vote recommendation. In this scenario we provide rationale to justify our voting decision.

The first section of this report details the overall votes cast and the breakdown of these votes. In cases where we voted "AGAINST" management, rationale is provided.

During the period there were 2 meetings and 9 votable resolutions across the companies: Alibaba Group Holding Limited and Unilever NV.



Voting statistics	
Meetings voted	2
Votes Cast	9
Votes "FOR" Management	9
Votes "AGAINST" Management	0

Votes by country	%
China	55.6
United Kingdom	44.4

Votes by Industry sector <sup>1</sup>	%
Internet & Direct Marketing Retail	55.6
Personal Products	44.4

■ "FOR" Management  
■ "AGAINST" Management

<sup>1</sup> Votes by Industry Sector uses the Global Industry Classification Standard ("GICS") coding level 3 "Industry" classification.  
Source: Veritas Asset Management, ISS

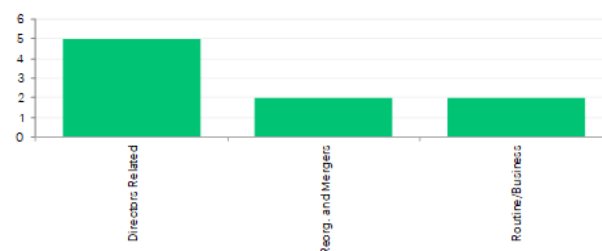
## Proxy Voting - Proposal Categorisation

The information provided below details the vote categorisation.

Vote categorisation <sup>2</sup>

Category	Votes "FOR" Management	Votes "AGAINST" Management	Total
Directors Related	5	-	5
Reorg. and Mergers	2	-	2
Routine/Business	2	-	2
<b>Total</b>	<b>9</b>	<b>-</b>	<b>9</b>

Votes "FOR" Management Categorisation



<sup>2</sup> Please refer to the glossary for descriptions of category classifications.  
Source: Veritas Asset Management/ISS

The second part of the voting report focuses on the customised Red Line element of our policy. Across the 9 resolutions voted during the period, the overall number of resolutions which triggered the Red Line element of our customised policy was 1. We voted in line ("FOR") on 0 resolutions and contrary to ("AGAINST") for the remaining 1 resolution. In keeping with the AMNT requirement to either comply or explain, please see below rationale examples where votes cast have resulted in a vote "Contrary to" the Red Line element of our policy.

<sup>1</sup> Number of Red Lines triggered and votes "FOR" or "AGAINST".



## Votes "FOR" and "AGAINST" VAM LLP Policy

Votes	Red line <sup>1</sup>	Total
Number of votes "FOR" Policy	-	6
Number of votes "AGAINST" Policy	1	3
<b>Total</b>	<b>1</b>	<b>9</b>



## VAM LLP Rationale – Votes “Contrary to” VAM LLP Policy Recommendation

Report Item	Company	Proposal	Red Line Vote Recommendation	VAM LLP Vote	Voter Rationale
1	Alibaba Group Holding Limited	Elect Walter Teh Ming Kwauk as Director	“Against”	“For”	<p>Veritas cast our vote “FOR” the Election of Walter Teh Ming Kwauk as Director.</p> <p>Against the recommendation of RL G9 – “The company's statutory auditors have for a period of 15 years or more been the same or drawn from the same firm.”</p> <p>We are comfortable with the functioning of the Board and do not view this matter as material enough to vote against the election of Walter Teh Ming Kwauk.</p>

## Company engagement example

### Svenska Handelsbanken

We have argued that Governance is central to Environmental and Social risks and opportunities. Forward thinking management that is incentivised in the right way, is more likely to adjust a business to Environmental and Social risks and opportunities. The only bank held by the portfolio, Svenska Handelsbanken, has not handed out bonuses for over 40 years. Instead, they have a profit-sharing scheme called the Oktogonen foundation, which only distributes the proceeds when the individual turns 60. This can be a generous pay-out to those that have served with the company for many years. All employees receive the same allocation based on the bank's performance against its rivals but there are no sales targets or budgets. Whilst each branch has autonomy to lend, the bank has a culture of looking over the long term and not taking big risks. The consequence of this has been a bank with an enviable ROC and one of the lowest bad loan books of any European bank. They have not had to be bailed out by any financial crisis or suffered AML scandals.



Given the recent announcement that the Bank proposes to change the Oktogonen scheme going forward and introduce bonuses, we felt the need to engage. At first sight this challenges part of the thesis under which the shares are held. This engagement is at the early stages with an initial meeting with the CEO and CFO taking place at the time of writing. We need to better understand the terms of the bonus proposal and whether there is a reduction in alignment (currently the Oktogonen allocates around 90% to the Banks own shares). Given that 90%+ of staff will have an interest in Oktogonen, this issue is not something that will necessarily have implications in the short term but as this interest dilutes over time the Bank's attitude to risk could be under pressure.

ROC – Return on capital

AML – Anti Money Laundering



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