NEDGROUP INVESTMENTS

see money differently

Nedgroup Investments Global Equity Fund

Quarter Four, 2020

Market Overview and Outlook

The two-speed market

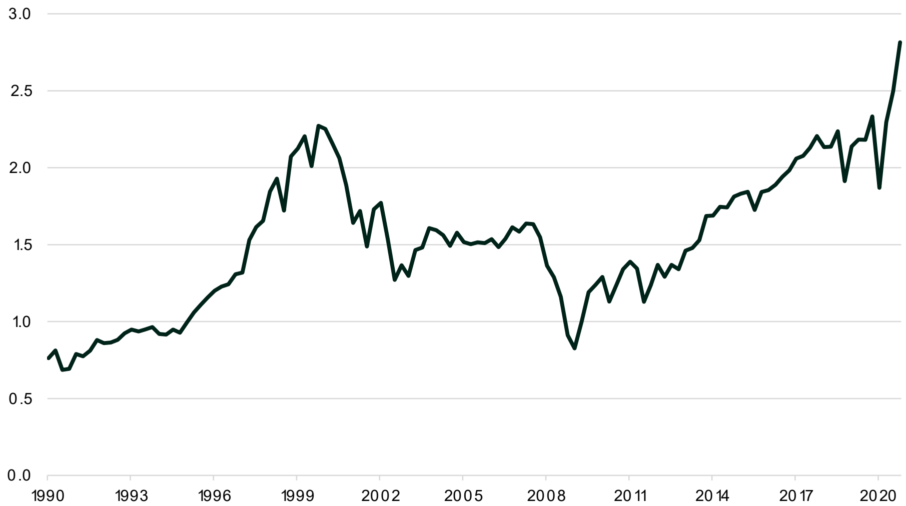
In many respects 2020 will go down as one of the worst years in most people's lives. COVID-19 has ravaged families and economies the world over leaving death, unemployment and severe social restrictions in its wake. Our hearts go out to those who have suffered the most severe consequences of this dreadful disease. With numerous vaccines now approved and more in development it is hoped that the light is now visible at the end of the tunnel. Unfortunately, vaccines cannot bring back those loved ones who have succumbed to the disease. The world that emerges from COVID-19 will be a different place. Hopefully, governments will now take the threat of pandemics more seriously such that in the future the human toll is minimised.

In the financial world too, 2020 will be remembered as an extraordinary year. Despite the pandemic impacting economies across the globe with GDP growth negative in most countries and with many countries suffering their largest ever decline in GDP, asset markets have risen substantially over the year. This is a direct consequence of actions taken by policy makers to reduce interest rates across the curve and provide excessive amounts of liquidity: in the economic universe, interest rates power everything.

Ultra-low rates and abundant liquidity are used to justify valuations and activity that historically would have been considered extreme. At year end the annual return available by buying and holding the ten-year government bond in the US, Germany and the UK would have been +0.9%, +0.2%, -0.6% respectively. Paltry returns and certainly well below inflation: buying these risk-free assets almost guarantees that the investor will lose purchasing power over a ten-year holding period. With this as the "risk free" alternative it makes almost everything look cheap in comparison and encourages investors to accept greater risk in order to generate a real (above inflation) return! Even a company trading at 100x price to free cash flow (a 1% free cash flow yield) that is growing looks cheap based on the ten-year bond yield at that moment in time. As a consequence, signs of speculative excess are increasing.

Valuation of equities are high in absolute terms. Ultra-low interest rates disproportionately benefit high growth companies where the earnings and cash (hopefully) flow in the distant future. This partly explains the 44% rise in the tech heavy Nasdaq index in 2020. Technology is now the largest single sector in the market (22% of MSCI World with the next largest sector, Healthcare at 13%). The price / sales ratio of the market is at all-time highs.

S&P 500 Price to Sales ratio



Source: Bloomberg

The cyclically adjusted Price Earnings ratio (of the US market) is at c.35x; a level only surpassed in the TMT (technology, media and telecoms) bubble of 2000. New valuation metrics are being adopted to help justify prices with the latest being price to sales divided by sales growth! Retail investors are increasingly active, drawn in by the lure of getting rich quick and the human inability to watch their neighbour get rich. Informed sellers are taking advantage of this – investment bankers, private equity and company insiders are monetising as never before: 2020 saw the highest ever volume (and value) of IPOs in the US (480 and $167bn) with over half of these in Special Purpose Acquisition Vehicles (SPAC's) which are cash shells set up specifically to make acquisitions using cash and paper. Other signs of speculative excess include largely unheard-of companies with no earnings (and some with no revenue) trading at multi billion market caps; share prices rising solely as a result of financial engineering such as stock splits that have no impact on value; the growing prevalence of fraud and the parabolic rise in some alternative assets (in the last quarter of 2020 alone Bitcoin rose from $10,707 to $28,996 (+171%) and in the first 8 days of 2021 has risen a further 42%).

Speculation is certainly rampant but is being justified by today's low rates; never before has so much relied on rates staying as low as they are today. As an investor that seeks to deliver good absolute returns over the long term this presents a dilemma – will rates remain low for the duration of our investment horizon and if not, what are the consequences?

Implications for the portfolio

Fortunately for us, not all investments are subject to the same speculative fervour. Companies that do not have potentially huge untapped total a///ddressable markets (TAM); are not growing extremely fast but do generate lots of cash (and can thereby be valued based on that) are frequently trading at low valuations. They do not capture the imagination of speculators and are consequently ignored – it seems that if there is no prospect of their share prices doubling or better in the next twelve months, they are not worthy of consideration. As Warren Buffett once pithily put it "nobody wants to get rich slow".

Take the example of one of our long-standing positions, CVS Health Corporation. Through the 2018 acquisition of health insurer Aetna, CVS became a behemoth in US healthcare services. The company's assets include not only Aetna, the country's 5th largest health insurer, but also Caremark, the largest Purchasing Benefits Manager (PBM) - together these companies have a membership base of 100m Americans. This is further combined with the infrastructure of CVS Pharmacy, the nation's largest retail pharmacy chain with over 10,000 retail pharmacies. The thesis behind our holding is that over the next few years CVS will increasingly integrate these three assets (health insurance / PBM / retail including care delivery) and invest more in healthcare delivery assets at retail to strengthen their position. The context is also favourable, with a Democratic administration motivated to expand healthcare coverage in the US. These factors will enable CVS Health to deliver mid to high single digit growth in revenues and operating income and around 10% growth in earnings and free cash flow available to shareholders.

Few would disagree that US healthcare delivery is complex, fragmented and expensive, both as a proportion of GDP and to the individual. At the heart of its inefficiency are misaligned incentives and CVS Health, as a vertically integrated payer and provider, is preferentially positioned to align incentives to drive improved and more economical healthcare delivery. Upside to our central case could well arise should the integration of their assets (together with further care delivery assets) lead to better care at a lower price for Aetna enrolees. Aetna could then offer preferentially priced health insurance plans and gain profitable market share.

CVS Health are intent on 'meeting the customer where and when they want to be met' and, as such, are implementing on a strategy to convert around 3,000 of their retail stores into "Health Hubs". These hubs will provide complementary and primary care services, such as diagnostic testing, vaccinations, health screening and advice in the same location as all related healthcare products. The aim is for health services to be more convenient (longer operating hours including weekends and with no queues) and at lower cost (the cost to CVS is likely to be around 50% lower than a primary care physician cost) which would allow Aetna to include Health Hub visits for very low cost or free within some of their insurance products.

Better coordination would then facilitate better health outcomes especially for those with chronic conditions. This virtuous circle of improved care at lower cost is within the control of management. Importantly they already have the assets needed to deliver this vision largely in place together with the necessary data and understanding required as a consequence of having proprietary medical claims, pharmacy and prescription data. Indeed, very recently Aetna have launched, to much broker interest, "Connected Care Plans" in two areas with sufficient density of CVS Health Hubs. These plans are priced below local benchmarks and the lower projected medical cost is enabled by fully utilising CVS Health assets.

Two notable events have recently catalysed CVS Health's strategy. The newly appointed CEO of CVS, Karen Lynch who assumes the role in February, has impressed us with both her understanding of what is required to deliver on this vision and her drive to deliver it. Her track record in execution at Aetna is excellent and the recent senior appointments she has made are supportive of our thesis. Further, COVID-19 has highlighted the power and necessity of local healthcare delivery. CVS Health rapidly set up 1,800 COVID-19 testing centres, conducting over 7 million tests to date (with 70% of patients not previously CVS retail customers) and are instrumental in the vaccine roll-out in the US. This dreadful pandemic has enabled CVS Health to potentially emerge as synonymous with healthcare delivery in local communities.

Obviously, delivery of this outcome is not pre-ordained and there are some notable risks. Uppermost in most commentators' minds is the threat from Amazon to the retail stores and the company's prescription mail order business. However, we believe the threat from Amazon is overstated due to the transition CVS is making in changing retail pharmacies to more service-based facilities together with idiosyncrasies of the pharmacy market which should help protect CVS. Some of the issues include:

- A desire to obtain prescriptions immediately for acute conditions (even next day delivery is not good enough when you are in pain or suffering an infection). Around 30% of prescriptions are for acute conditions.

- With 10,000+ retail locations CVS can offer same day delivery (within two hours) for online purchases in urban areas where they have store density. CVS Health already have permission to text 89m Americans to let them know when their prescription is ready or has been dispatched.

- Mail order pharmacy is already largely online and most is fulfilled at low margin on 90 day prescription for chronic conditions. Provided these refill prescriptions are mailed to patients in time (i.e. before their current supply expires) there would seem little demand for faster delivery.

- With branded drugs, the large PBMs, of which Caremark is the largest, have significant buying power – Amazon cannot replicate this until it is buying billions of prescriptions. The large PBMs use this buying power to lower drug costs through negotiating with the pharmaceutical companies. The PBM industry is one of scale.

- Lower costs for Aetna enrolees at CVS – CVS can offer discounts to its own members for filling their prescriptions at CVS stores (or through Caremark mail order).

Whilst Amazon will remain a formidable presence, it is also true the company has failed to infiltrate or disrupt industries where there has not been the customer need for improved delivery speed or convenience, for example in life sciences supplies and dental supplies. We believe pharmacy will be similarly unimpacted.

The second risk to CVS is regulatory – should there be a major change to the way drugs are bought in the US then there is potentially a risk to the Caremark PBM. In particular, a single Government buyer of all drugs would eliminate the need for PBMs. However, this is unlikely to occur given a moderate Democrat inhabiting the White House and a lack of bipartisan support historically. The margin of the PBMs has been under some pressure in recent years as they have come under increasing scrutiny and they have deepened care management services to customers in response.

This focus on their role is likely to continue although the pace to date (and expected in the future) still allows the three large PBMs to grow in the low single digits. The service they perform (largely aggregating demand to reduce prices but also more value-added service such as formulary management, specialty drug management etc.) is critical to those buying drugs (largely insurers and large corporates) and this is reflected in the 98% customer retention ratios that the large PBMs have typically delivered. Consequently, while mindful of this risk, we believe it to be manageable by CVS.

In a worst-case outcome, the earnings and cash flows of CVS are likely to grow only at low single digits. In our base case the earnings and cash flows will grow at a high single digit annually. This may not sound attractive to investors looking for the next Tesla. However, the company already generates prodigious free cash flow (around $12bn annually) and with a market capitalisation of c.$90bn this represents a 13% free cash flow yield. Admittedly with relatively high debt levels ($75bn as a result of the Aetna acquisition) much of this free cash flow will be needed to pay down debt over the next two years. The current free cash flow / Enterprise value (EV) which includes the debt is 8.5% although as debt is naturally paid down over the next couple of years this ratio automatically increases rising to 10% EV / Free cash flow in 2023. To our minds, CVS represents an attractively valued, dominant company with reasonable growth prospects over the next 5 to 10 years.

Longer term perspective

Since the inception of Veritas we have had the aim of delivering good real returns for clients over our investment time horizon. In the almost 20 years since, we have delivered on this aim, achieving good absolute returns and consequently have outperformed global equity markets. We have done this with relatively low volatility by sticking to our investment philosophy of buying good quality companies when they are attractively valued on an absolute basis. This has often meant that performance relative to equity markets has been delivered when equity markets have declined. This performance profile was replicated in the compressed cycle we experienced in 2020 – during the first quarter as markets declined, the portfolio also declined but to a lesser extent, delivering substantial outperformance against the market. As animal spirits returned and fear turned to greed our outperformance unwound and with the rapid growth-driven rise in equity markets in the final quarter.

“To finish first, you must first finish” – Juan Manuel Fangio

Fund performance contributors & detractors for past quarter

	Portfolio			Index			Attribution
Holding	Average Weight	Total Return	Absolute Contribution	Average Weight	Total Return	Absolute Contribution	Total Effect
Top 5 relative stock contributors							
Safran	5.5	43.1	2.1	0.1	43.3	0.0	1.3
Airbus	4.5	50.6	1.9	0.1	50.9	0.1	1.2
Alphabet	7.8	19.4	1.6	2.1	19.6	0.4	0.4
Aena SME	3.1	24.3	0.7	0.0	24.4	0.0	0.3
Microsoft	0.5	3.3	0.1	3.2	5.9	0.2	0.3
Bottom 5 relative stock contributors							
Alibaba Group	3.6	-20.8	-0.9	–	–	–	-1.4
Charter Communications	6.8	6.2	0.4	0.2	6.0	0.0	-0.5
Baxter International	3.5	0.0	0.0	0.1	0.0	-0.0	-0.5
Unilever NV	2.8	0.3	0.0	0.1	0.1	0.0	-0.4
Mastercard	3.7	5.7	0.1	0.6	5.6	0.0	-0.3

Source: Veritas Asset Management

	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	9.4	-6.7	-0.6	3.5	20.1	0.7	0.3	-2.5	-2.1
Africa/Middle East	–	–	–	0.2	19.2	0.0	-0.0	–	-0.0
Europe ex UK	24.2	23.8	5.8	14.9	15.2	2.3	0.1	2.1	2.2
Japan	–	–	–	7.8	15.3	1.2	-0.1	–	-0.1
North America	58.8	10.4	6.2	69.4	13.1	9.1	0.1	-1.4	-1.3
United Kingdom	5.5	10.1	0.3	4.2	16.9	0.7	-0.0	-0.5	-0.5
Cash and equivalents	2.2	n/a	0.0	–	–	–	-0.3	–	-0.3
Total	100.0	11.8	11.8	100.0	14.0	14.0	0.1	-2.2	-2.2

Source: Veritas Asset Management

	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	3.6	-20.8	-0.9	12.0	16.2	1.9	-0.1	-1.6	-1.6
Consumer Staples	8.0	3.9	0.2	7.9	6.4	0.5	-0.0	-0.2	-0.3
Energy	–	–	–	2.6	26.7	0.7	-0.3	–	-0.3
Financials	6.5	17.4	1.1	12.4	24.0	2.9	-0.5	-0.4	-1.0
Health Care	29.7	8.0	2.5	13.3	6.8	0.9	-1.1	0.5	-0.7
Industrials	24.9	26.9	6.2	10.6	15.3	1.6	0.1	2.5	2.5
Information Technology	7.5	6.8	0.5	21.8	12.9	2.7	0.2	-0.5	-0.3
Materials	–	–	–	4.5	15.8	0.7	-0.1	–	-0.1
Communication Services	17.6	11.3	2.2	8.9	15.6	1.4	0.1	-0.6	-0.4
Utilities	–	–	–	3.3	9.3	0.3	0.1	–	0.1
Real Estate	–	–	–	2.7	8.6	0.3	0.1	–	0.1
Cash and equivalents	2.2	n/a	0.0	–	–	–	-0.3	–	-0.3
Total	100.0	11.8	11.8	100.0	14.0	14.0	-1.8	-0.4	-2.2

Source: Veritas Asset Management

Portfolio Attribution Commentary

The key development over the last quarter was the announcement of positive vaccine news, with efficacy that surpassed expectations. Approval to now administer the vaccines is starting to scale and unsurprisingly, the result was a positive reaction in some equities that had been previously hit by the pandemic. Most notably within the portfolio was the aerospace sector which had been added to on weakness. Airbus, Safran and Aena all rose significantly over the quarter.

There have been several underlying reasons for the sharp rises over the quarter: 1) the likelihood of leisure passengers returning to travel in 2021 has improved with vaccine development with efficacy at 90% and with increased use of fast-paced testing (antigen and PCR). 2) Airbus delivered 566 planes last year, more than expected and will ramp up production from 40 narrow-body (NB) planes to 45 by end 2021. There were 87 customers taking delivery of planes compared to 99 in 2019 so fewer customers cancelling than expected. China (which has seen regional travel return to pre-COVID levels) took 18% of all deliveries. 3) 70% of Safran's sales are exposed to the NB market. The company is likely to benefit from 2022 from a traffic recovery in Developed Markets and large domestic markets as service/parts revenue ramps up again. 4) Safran is ahead of peers on cost cutting and cash control. Additionally, Boeing’s Max, for which Safran provides the engine, re-certification is positive. Investors are starting to look through 2021 given vaccine newsflow is supportive for such an aftermarket-oriented business (c.45% of 2019 sales). 5) Aena largely operates Spanish airports which should be one of the first areas to benefit.

2021 traffic recovery will likely be led by areas that have access to vaccines and testing (US, Japan, UK, EU, Korea, Russia, China), higher spending power/social support or have contained the virus. These domestic/intra-regional markets accounted for 40% of global Revenue Passenger Kilometers (RPKs) in 2019. With 70% of sales exposed to NB, c.40% of CFM56 installed engines operated by Low Cost Carriers, Safran's engine portfolio is well positioned to benefit from a boost in leisure, intra-regional air travel from mid-2021. Airbus from increased delivery of NB planes.

Fast testing is a significant factor in reducing the number of travel restrictions before a vaccine is widely distributed. There are many anti-gene quick 15 minute tests starting to be adopted across the world by governments and airlines. A good example is Singapore, who are to develop a PCR swab test (previously would take 3.5hrs to two days depending where you live) with a lab based at Changi airport that can provide a result within 1.5 hours. As an example; post the vaccine news, Ryanair (300+ 737 CFM powered fleet) has mentioned that summer capacity 2021 could be back at 70-80% of 2019 levels.

COVID-19 has had more structural impact on working from home (WFH), reduced business travel which may have longer lasting effects on long haul travel. A widebody (WB) recovery will likely take more time, but cargo has helped to keep some long-haul flights and the vaccine distribution for 2021 are likely to prolong the boost. Safran has pointed to a cargo benefit in their 3Q20 results. For Safran the benefit was on the GE90 engine on 777 planes which declined only 15-20% vs the CFM56 which was down 70% in 3Q20 vs 3Q19. A 747 cargo plane can fit 3-4 pallets of vaccine doses with dry ice to maintain the temperature. DHL has estimated that providing a dose to 7.8bn people would fill 8,000 747 cargo aircraft.

Beyond medical advances and testing regime availability, one needs to consider demand and household savings, as these could influence consumer choices to allocate their savings to services once the restrictions end, and most likely with it some of the social support packages. Overall the level of savings has improved compared to the pre-COVID years. The level of savings has increased, especially in nations where the job support schemes have been put in place and protected against unemployment. Judging by the demand for travel in countries like China, where internal flights are back to pre-COVID levels, it’s likely the demand to get back on a plane is being significantly underestimated.

Retirement of old wide-bodies and narrow-bodies could get close to 1,000 planes per annum in 2020-21. Airlines have been prompt in announcing the retirement of four engines aircraft such as the 747, A380 and A340. As of

October 2020, there were approximately 540 air transport aircraft officially retired (51% narrow-bodies, 40% wide-bodies and 9% regionals) and withdrawn from use which is 2.6% of the active fleet.

Official year end figures could see this number growing to c.4.5-5% of the fleet which is close to c.1,000 planes. Using similar proportions as of the past nine months, we could have another c.250-300 narrowbodies retired of which 70% could be for CFM powered. This would be a removal of 700 engines per annum out of c.21,500. Typically the first engine shop visit happens around years 6-8, the second one in the years 12-14 and these represent c.80-85% of revenues made by new parts manufacturers. For the total CFM-56 2nd gen fleet 57% are less than 10yrs old, 45% have not seen a shop visit, and 40% have seen one. Original equipment (OE) demand will remain driven by airlines' willingness to reduce fuel costs and carbon emissions midterm (albeit a low oil price in the short term may delay that move).

Safran has undertaken a €2bn cost-savings programme, of which 50% relates to full-time employee reductions (c.15% of personnel costs). It’s likely we could see c.18% group margin in 2024, as cost reduction, hedge rate tailwind and aftermarket growth more than offset the weakness of more widebody-exposed activities (which may take longer to recover).

In short, the impacts of COVID-19 and a continued focus on carbon emissions reductions are likely to weigh on overall aircraft demand medium-term. Airbus has indicated it will increase production to 47 A320’s (its most popular model for short haul travel) despite COVID pressure and based on the durability of its backlog of orders. Japan Airlines for example is raising $1.6bn in a share issue to lower debt and pay for planes ordered in 2013.

It’s worth noting that Airbus is likely to be included in Germany’s DAX index as Deutsche Boerse AG will scrap a rule on German stock turnover that has kept Airbus out of the DAX for years. This would provide exposure to passive funds. Over 35bn Euros in assets is benchmarked against the DAX. Additionally, the Airbus helicopters business has won a number of orders including from German’s Bundeswehr who have ordered 31 NH90 helicopters for navy’s shipborne operations.

Safran’s aftermarket activities will recover on the back of leisure travel recovery, starting with domestic travel and then long-haul travel at a later point (although lockdown ‘bucket lists’ suggest this may improve quicker than expected).

Also related to the positive vaccine news was a rise in the shares of Catalent. Catalent is a Contract Development Manufacturer (CDM) that provides integrated services, delivery technologies and manufacturing solutions to develop and launch pharmaceuticals, biologics and consumer health products. Catalent makes 70 billion+ doses of all kinds of drugs each year. Globally, the company is currently working with 75 COVID related programs including antivirals, vaccines, diagnostics and treatments across its biologics, gene therapy, oral technologies and clinical supply businesses. For example, Moderna raised global production estimate for its mRNA-based coronavirus vaccine for 2021 by 20% to 600 million doses. So far, the company’s coronavirus vaccine has received emergency use approval in the United States and Canada. Additionally, Israel’s Ministry of Health also granted authorization to import the COVID-19 vaccine. Moderna has a supply agreement for 200 million doses with the United States that are due to be delivered during the first half of 2021. The United States government has an option for an additional 300 million doses of the vaccine. Moderna has signed an agreement with Catalent to provide the vial filling and packaging of the virus. Catalent has also signed an agreement with AstraZeneca to provide drug substance manufacturing to AstraZeneca for the University of Oxford’s adenovirus vector-based COVID-19 vaccine, AZD1222, at Catalent’s commercial gene therapy manufacturing facility. This agreement expands Catalent’s support of the AZD1222 program following the announcement in June that Catalent’s facility in Anagni, Italy, will provide large-scale vial filling and packaging of AZD1222.

Alphabet benefited from a broad-based improvement in advertiser’s spend across all geographies and nearly all verticals including both search results as well as the rebound in brand advertising spend on YouTube. Google ad sales accounted for 80% of Alphabet’s revenue. Google’s billions of users are spending more time online transacting and entertaining themselves this year as they try to avoid the coronavirus. Advertising revenues rose to $37.1 billion from $33.8 billion, following a two straight quarters of year-over-year declines. YouTube ad revenue rose to $5.04 billion from $3.8 billion a year ago, while Google Cloud sales rose to $3.44 billion from $2.38 billion. Earnings benefited from cutbacks in marketing and travel and in particular a 20% drop in spending on equipment and workspace construction.

Alphabet said it would elevate cloud into a separate reporting unit starting in the fourth quarter, effectively dropping cloud financial results from its Google unit and giving investors their first view into the business' profitability. Management did not provide formal guidance for its Q4. Despite the significant uptick in brand advertiser spending that clearly benefitted Q3 results, management noted a high degree of uncertainty in the macro-environment that limits future visibility.

The main detractor over the period was Alibaba, which holds a 33% stake in Ant Group. The IPO in Ant Group, which was to list in both Shanghai and Hong Kong, was pulled at the eleventh hour. Days earlier, draft measures were being drawn up for online micro lending, which makes up 40% of Ant's revenue. Ant has attempted to brand itself as a tech company, even changing its name from Ant Financial to Ant Group. But it was clear that Ant's future would be dependent on banking regulators, whose founder, Jack Ma had criticised a few days earlier. Ma took to the stage at a conference in Shanghai and gave a 20 minute verbal criticism of government regulation that would suffocate innovation in China. He referred to 'pawn shop' mentality amongst Chinese lenders, regulators who did not understand the internet and the 'old men' of global banking community. Needless to say, Ma received a dressing down from Beijing and the IPO was subsequently pulled. The proposed new rules mean that Ant Group and other online lenders will be treated more like banks. Ant will need to hold significantly more capital to back loans made on their platforms and there will be a cap in how much they can lend to each individual (either Rmb 300k (approx. $45k) or one third of a borrows annual pay whichever is lower). Ant's payment platform, Alipay is ubiquitous in China but the fast-growing consumer lending business was the driving force behind the IPO. The business acts as a high-tech middleman between borrowers and banks taking approx. 2.5% fee for each loan it arranges. Ant took almost none of the risk on from 1.7 trillion Rmb in consumer loans. It may now need to provide much more of the capital itself and hold more loans on its own books (could rise to 20% if treated like other lenders in China). If Ant re-emerges for listing, the business model may be different to that it pitched for the IPO. Whilst it undoubtedly changes the valuation and the value of Alibaba's 33% stake, the drop in the price of Alibaba provides an opportunity to add to a compelling long-term opportunity.

The company is growing at a healthy pace (revenues expected to grow at up to 40% over next twelve months), with its Tmall and Taobao marketplaces continuing to attract Chinese shoppers and Alibaba Cloud remaining Asia's top cloud infrastructure platform. There is much press given to anti-competitive behaviour, but it is hard to argue that consumer interests have been damaged by Alibaba. Consumers have been enabled to set up businesses and many goods and services are cheaper as a result of their platforms. There is significant competition in e-commerce within China, with the likes of JD.com and Pinduoduo ensuring that the take rate (percentage paid by merchants) at Alibaba, at approx. 2.5%, is much lower than that at Amazon (approx. 12%).

Away, from Alibaba, the other main detractors were stocks that simply rose less than the market. Some have performed well over twelve months. Charter Communications, for example, has been a beneficiary of the pandemic and the work from home environment. The demand for high speed internet has meant that EPS has risen from $5.30 to £13.0 in the last twelve months. The base of internet users has risen 8.8% over twelve months to 28.6 million. Revenue has expanded due to a growing internet subscriber base and higher revenue per user but the impact on earnings has been more pronounced given that the cable business incurs significant fixed costs related to setting up infrastructure, with incremental costs related to adding and servicing new customers being very low. In the last quarter, for example, EPS came in at $3.90 up from $1.74 a year ago. There is some concern that as we see an end to the pandemic, together with already high broadband penetration, growth will slow. However, one consequence of COVID, is the acceleration of digitalisation and with it people placing a higher value on their home internet connection. That brings pricing power. Charter already has the infrastructure in place to upgrade networks and add speed and capacity relatively more seamlessly and cost effectively compared to wireless and phone companies.

Unilever was another position that lagged the sharp rising market. During the quarter, the company unified its complex legal structure (came into effect on 29 November) under a single parent company so that its legal base is in London. The move sees the company abandon a dual-headed structure that has been in place for more than 90 years when a Dutch margarine company merged with a British soap company.

Operating as a single based entity gives the company 'greater flexibility for strategic portfolio change' (Chairman, Nils Anderson). This paves the way for Unilever to accelerate its move towards fast growing sectors and selling businesses like its Tea franchise.

Sonic Healthcare is an Australian quoted global pathology business and one of the main companies involved in diagnosing COVID-19 cases in countries in which it operates. The company achieved 29% growth in revenue in the three months to end September 2020 (the first quarter of its Fiscal Year 2021). Sentiment amongst Australian healthcare names was hit when CSL shelved the development of its COVID vaccine but given that COVID testing is likely to remain strong throughout winter in the US/Europe where Sonic has a significant presence, this has little impact on Sonic.

Baxter International products are used in hospitals, kidney dialysis centres, nursing homes, rehabilitation centres, doctors' offices, and patients at home under physician supervision. The company sells its products through direct sales force, as well as through independent distributors, drug wholesalers, and specialty pharmacy or other alternate site providers in approximately 100 countries. Baxter has seen increased demand in some of its medical devices during the COVID pandemic, including its blood purification systems PrisMax and Prismflex, which are used to treat acute kidney injuries but has seen a drop in some of the hospital products used in elective surgery. The company is well positioned against longer term trends e.g. lifestyle diseases and value based healthcare. During the quarter the company offered to buy Omnicell, a medication management software vendor. Omnicell provides automation and analytics solutions to more than 7000 healthcare facilities worldwide, a service very much in demand as these entities become more efficient and look to save costs.

Current Positioning

Top 10 Portfolio Holdings

Holding	Sector	Country	Portfolio %
Alphabet	Communication Services	United States	7.2
Charter Communications	Communication Services	United States	6.4
Safran	Industrials	France	5.2
Airbus	Industrials	France	4.4
Canadian Pacific Railway	Industrials	Canada	4.1
BAE Systems	Industrials	United Kingdom	4.1
Fiserv	Information Technology	United States	3.9
Intercontinental Exchange	Financials	United States	3.7
Vinci	Industrials	France	3.6
UnitedHealth	Health Care	United States	3.6
Total			46.2

Source: Veritas Asset Management

Portfolio Breakdown

Region	Portfolio %
North America	60.9
Europe ex UK	20.2
Asia Pacific ex Japan	8.4
United Kingdom	7.1
Cash and equivalents	3.3
Total	100.0

Sector	Portfolio %
Health Care	29.5
Industrials	24.5
Communication Services	16.5
Information Technology	10.1
Consumer Staples	6.6
Financials	5.9
Consumer Discretionary	3.5
Cash and equivalents	3.3
Total	100.0

Currency	Portfolio %
USD	67.7
EUR	19.3
AUD	4.9
GBP	4.1
SEK	2.2
CHF	1.7
CAD	0.0
Total	100.0

Source: Veritas Asset Management

Responsible Investment

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 4 meetings and 45 votable resolutions across the companies: Aena S.M.E, Catalent Inc, Cochlear Limited and Sonic Healthcare.

Voting statistics	
Meetings voted	4
Votes Cast	45
Votes "FOR" Management	40
Votes "AGAINST" Management	5

Votes by country	%
Australia	46.7
Spain	35.6
United States	17.8

Votes by Industry sector [1]	%
Transportation Infrastructure	35.6
Health Care Providers & Services	26.7
Health Care Equipment & Supplies	20.0
Pharmaceuticals	17.8

[1] 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.

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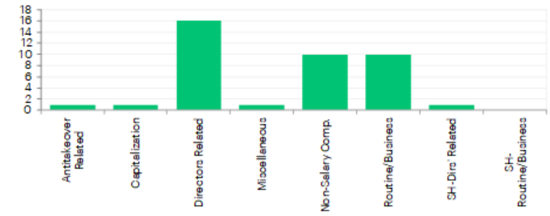
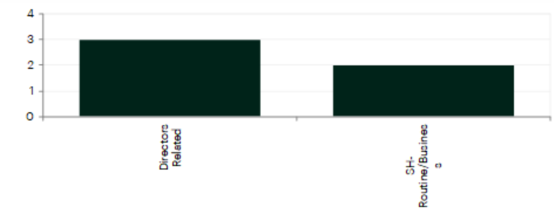
Vote categorisation [1]

Category	Votes "FOR" Management	Votes "AGAINST" Management	Total
Antitakeover Related	1	-	1
Capitalization	1	-	1
Directors Related	16	3	19
Miscellaneous	1	-	1
Non-Salary Comp.	10	-	10
Routine/Business	10	-	10
SH-Dirs' Related [2]	1	-	1
SH-Routine/Business [2]	-	2	2
Total	**40**	**5**	**45**

Votes "FOR" Management Categorisation



Votes "AGAINST" Management Categorisation



[2] Please refer to the glossary for descriptions of category classifications.
Source: Veritas Asset Management/ISS

Across the 45 resolutions, votes cast by VAM LLP resulted in 40 votes “FOR” management and 5 votes “AGAINST”. Please see detailed below rationale examples where votes cast have resulted in a vote “AGAINST” management.

VAM LLP Rationale – Votes “AGAINST” Management Recommendation

Report Item	Company	Proposal	Management Vote Recommendation	VAM LLP Vote	Voter Rationale
1	Aena	Approve Instructions to the Board to Present the Climate Action Plan at the 2021 AGM and Updated Climate Action Reports	“AGAINST”	“FOR”	A vote FOR these items is warranted as the requested reporting and updates on the company's climate transition plan will improve Aena's transparency on its environmental actions and is not deemed overly burdensome for the company. There is no legal risk associated with the advisory vote on the climate transition plan or reporting.
2	Catalent	Elect Director Madhavan "Madhu"	“FOR”	“AGAINST”	
3	Catalent	Elect Director J. Martin Carroll	“FOR”	“AGAINST”	A vote AGAINST the following directors; Madhavan "Madhu" Balachandran, Christa Kreuzburg, and J. Martin Carroll were warranted given the board's failure to remove, or subject to a sunset requirement the supermajority vote requirement, to enact certain changes to the charter which adversely impacts shareholder rights.
4	Catalent	Elect Director Christa Kreuzburg	“FOR”	“AGAINST”	

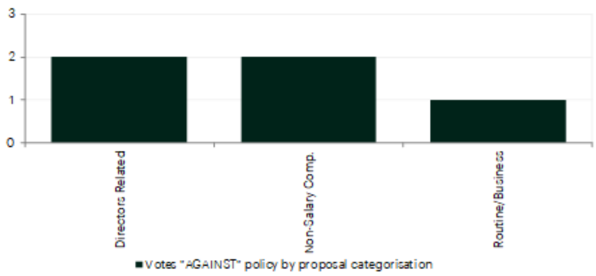
Source: Veritas Asset Management

Proxy Voting - ESG Red Lines

The second part of the voting report focuses on the customised Red Line element of our policy. Across the 45 resolutions voted during the period, the overall number of resolutions which triggered the Red Line element of our customised policy was 5. We voted in line ("FOR") on 0 resolutions and contrary to ("AGAINST") for the remaining 5 resolutions. 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.

Votes "FOR" and "AGAINST" VAM LLP Policy

Votes	Red line[1]	Total
Number of votes "FOR" Policy	-	40
Number of votes "AGAINST" Policy	5	5
Total	**5**	**45**



Source: Veritas Asset Management

[1] Number of Red Lines triggered and votes "FOR" or "AGAINST".

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

Report Item	Company	Proposal	Red Line Vote Recommendation	VAM LLP Vote	Voter Rationale
1	Cochlear	Accept Financial Statements and Statutory Reports	“AGAINST”	“FOR”	Veritas cast our vote “FOR” the Approval of the Financial Statements, against the recommendation of Red Line G15 – “There is no separate resolution to approve the final dividend.” Following the exceptional litigation settlement and the impact of COVID-19 on trading conditions, there was no dividend this year. The company have clearly stated they will resume payment of a dividend when trading conditions and cash flow generation has stabilized.
2	Aena	Advisory Vote on Remuneration Report	“AGAINST”	“FOR”	Veritas cast our vote “FOR” the Approval of the Remuneration Report, against the recommendation of Red Line G18 – “Absence of incentives based on performance conditions over at least three years.” As Aena are 51% owned by the Spanish Government, all remuneration policies are imposed by the Government to fit the civil service pay scheme. This means that it is not possible for the company to include incentives based on performance conditions over three years or more.
3	Sonic Healthcare	Elect Neville Mitchell as Director	“AGAINST”	“FOR”	Veritas cast our vote “FOR” the re-election of Neville Mitchell, against the recommendation of Red Line G9 – “The company's statutory auditors have for a period of 15 years or more been the same or drawn from the same firm.” Following our engagement with Sonic Healthcare’s Board and their reflection of our recommendations on executive compensation in the remuneration report. We voted with Management on all resolutions tabled for the 2020 AGM. We do not view the company’s statutory auditors having been in place for 15 years or more a reason to vote against a director given the dearth of competitors in audit for larger companies in which we invest. As well, the evidence that tenured auditors lead to poor governance is mixed at best.

Source: Veritas Asset Management

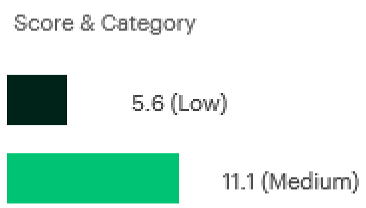
Portfolio Carbon Analysis Overview

The Carbon Portfolio Report provides a deeper understanding of a portfolio’s position with regards to the transition towards a low carbon economy. It compares the portfolio with a benchmark across five carbon assessments: Carbon Risk Rating, Carbon Intensity, Fossil Fuel Involvement, Stranded Assets Exposure, and Carbon Solutions Involvement. The combination of these assessments provides a multi -dimensional view of the portfolio’s performance versus the benchmark and provide useful insights about the portfolio holdings.

Portfolio Global Developed Benchmark

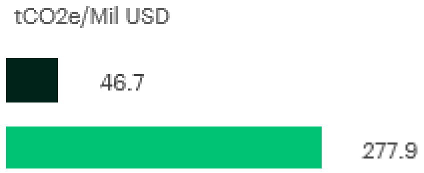
Carbon Risk Rating

The Carbon Risk Rating quantifies the company’s exposure and management of material carbon issues in its own operations as well as its products and services. Overall, the portfolio falls into the Low carbon risk category, and has 49% lower carbon risk than the benchmark.



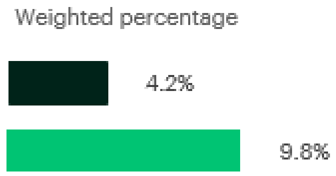
Carbon Intensity

Carbon intensity is a relative metric used to compare company emissions across industries. Sustainalytics divides the absolute emissions by total revenue, meaning the figure is expressed in tonnes of carbon dioxide equivalent per million USD of total revenue. Overall, the portfolio is 83% less carbon intensive than the benchmark.



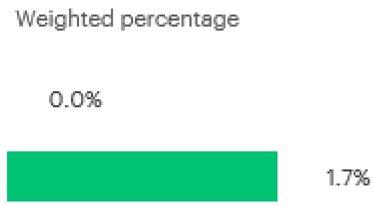
Fossil Fuels

Fossil Fuel Involvement measures the percentage of revenue that companies derive from thermal coal extraction, coal based power generation, oil & gas production, oil & gas-based power generation, and oil & gas - related products and services. Overall, the portfolio has 57% less exposure to Fossil Fuels than the benchmark.



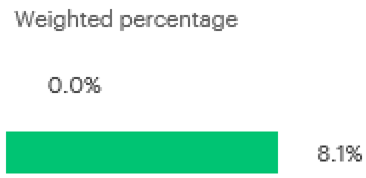
Stranded Assets

The Stranded Assets Exposure Score assesses the financial risk associated with fossil fuel production and reserves, and any specific involvement in high-cost fossil fuel projects. Overall, the portfolio has 100% less exposure to Stranded Asset Risk than the benchmark.



Carbon Solutions

Carbon Solutions Involvement measures the percentage of revenue that companies derive from green transportation and renewable energy. Overall, the portfolio has 100% less exposure to Carbon Solutions than the benchmark.



Source: Veritas Asset Management

Carbon Analysis report commentary

Context

Companies have come under increasing pressure to align their business strategy with the Paris Agreement climate goals, which aim to keep global warming this century well below 2 degrees. Each quarter we highlight how some of the holdings within the portfolio are aligning themselves with Paris climate goals.

Unilever

Unilever will ask its shareholders to vote on its climate transition action plan. The climate transition goals it will be putting to its shareholders in the vote, include net zero emissions from its own operations by 2030, a 50% reduction in average footprint of its products by 2030, and net zero emissions from sourcing to point of sale, by 2039. Achieving these targets will require Unilever to decarbonise its raw materials, transition to 100% renewable energy within its operations, eliminate deforestation from its supply chain, advocating for accelerated decarbonisation of global energy, and product reformulation. The move represents the first time a major global company has voluntarily committed to put its climate transition plans before a shareholder vote. The move may encourage other companies to engage with shareholders in discussing the shift to net zero emissions. The decision also follows the company's other sustainability activities such as its intention to increase plant-based sales to $1.2 billion by 2025, its acquisition of non-profit-backed nutrition group, SmartyPants Vitamins (has a long-standing partnership with non-profit organization, Vitamin Angels, to provide life-changing vitamins for mothers, expectant mothers, and children in need worldwide); and its $1 billion investment in removing fossil fuels from its cleaning products. Unilever's CEO has made a firm commitment: "Climate change is the most pressing issue of our time and we are determined to play a leadership role in accelerating the transition to a zero-carbon economy." "We have a wide ranging and ambitious set of climate commitments – but we know they are only as good as our delivery against them. That's why we will be sharing more detail with our shareholders who are increasingly wanting to understand more about our strategy and plans." The company said that it will share its full climate transition action plan in Q1 2021, ahead of its AGM on May 5. It added that it will report on annual progress against the plan from 2022, and it will seek an advisory vote every three years on any material changes made or proposed to the plan.

Aena

Aena shareholders voted in favour of an action plan against climate change at the Spanish airport operator's annual general meeting. Under the new goals, airports in Aena's network will be 100% energy self-sufficient - largely using solar panels - and carbon neutral by 2026. That should help it meet targets set out in the Paris Agreement. The company also hopes to reach net-zero emissions by 2040, instead of the initially planned 2050 deadline, meaning it would not rely on compensation mechanisms to make up for its emissions. Progress will be evaluated annually. Airport operators around the globe are facing dual challenges of coronavirus travel restrictions and pressure to reduce their carbon footprint. Aena decided to take advantage of sharply lower air-traffic and government green incentive programs to make structural changes to its business. It has invested 15 million euros in solar panel installations across its networks, with 335 million euros yet to be spent. The push to minimise emissions is be written into contracts across its different business areas, like handling and other third-party services. Aena has earned the highest rating awarded by the Carbon Disclosure Project (CDP) which has assessed its strategy for combating climate change and the measures it has put in place in this area. The Carbon Disclosure Project scores companies on a scale from the highest level A to the lowest level D and which is comparable among firms in the same region or industry. Spanish airport operator Aena is adopting, like Unilever, an annual advisory vote on the company's climate action plan. Aena will present its climate action plan for approval at the AGM in 2021 and then progress reports at each subsequent meeting. The company has also updated its articles of association to make its climate strategy a permanent addition to the AGM agenda.

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