Q1 2020 COMMENTARY
AMITY INTERNATIONAL FUND

QUARTER TO END MARCH 2020

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	-17.39%	-15.58%	-7.25%	-4.04%	15.52%	61.52%
FTSE World TR GBP	-16.14%	-14.98%	-6.00%	7.09%	42.34%	132.23%
IA Global	-15.71%	-14.07%	-6.35%	4.76%	30.77%	94.42%
Sector Quartile	3	3	3	3	4	4

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested.

REVIEW

The last three months have borne witness to numerous unprecedented events as the world responded to the Covid-19 pandemic. Global financial markets have been profoundly affected by the rapid spread of the coronavirus. Bonds rose and equities suffered significant declines as investors recalibrated relatively bullish year-ahead scenarios to reflect the economic stop, brought on as most of the world went into lockdown in an effort to contain the spread of the virus. Global monetary and fiscal response has been rapid and unparalleled, with the US announcing stimulus equating to c.10% of GDP, bettered only by Japan's 20% of GDP, while a co-ordinated response from Europe remained initially hamstrung by the usual political north/south divide. The recent sharp rally witnessed since equity markets bottomed on March 23rd, reflects the unprecedented monetary measures put in place, in particular, to avoid seizure of commercial paper, mortgage and credit markets particularly.

In the US, the spread of the virus lagged both Asia and Europe, however with relatively limited pre-emptive action the outbreak hit New York particularly severely with a delayed impact across the rest of the country. The Federal Reserve (Fed) initially cut interest rates twice in March to 0-0.25%, and announced unlimited quantitative easing (buying of bonds). This response was one of several unprecedented packages that the fast-acting Fed rolled out to address the dislocation in both credit markets, mortgage markets and beyond. In terms of key fiscal response, the US Senate passed its first $2 trillion stimulus package, which is equivalent to c.10% of GDP. The package included direct payments to households of around $1,200 with an additional $500 per child equating to a total of $250 billion. An additional $500 billion were loans to distressed companies, which was expected to be aimed at airlines and cruise operators. $350 billion was designated for small business loans, while $150 billion was earmarked for state and local stimulus funds. The US Administration's fiscal response was seen as critical to addressing the potential hardship felt by the American population, of which over 3 million filed for unemployment benefit in first week of the crisis, rising to 10 million by the start of April. US market's mirrored the volatility of global peers, with the circuit breakers being deployed several times due to excess volatility. US Treasuries were highly sought after, with the 10-year hitting a low of 32 basis points, coupled with a strengthening US Dollar as investor sought safe havens.

In Europe, the periphery countries of Italy and Spain became some of the most severely affected countries, with Italy experiencing the earliest shutdown on February 24th as the extent of the health crisis became clear. Spain was also particularly hard hit with the Prime Minister taking particular criticism regarding the handling of the crisis. The echo of the Great Financial Crisis of 2008, and subsequent Sovereign Debt crisis of 2011 was clear. European growth was already looking weaker, growing only 0.1% in last quarter of 2019, with periphery countries finances still in a precarious state. In contrast, to 2008, the European Central Bank (ECB) moved quickly with the Pandemic Emergency Purchase Programme (PEPP) equating to €750 billion of funding to purchase government and corporate bonds. However, despite the ECB flagging the urgent need for fiscal stimulus, the usual political north/south divide has led to an unnecessary delay in announcing a co-ordinated fiscal response. In the meantime, at a local level, governments have announced spending packages to assist business and household income, however long-term debt markets will need to assess these periphery countries ability and willingness to repay. In the Financials sector, regulators have pressured banks across Europe to suspend dividends and share buybacks until there is greater certainty regarding the impact, with many suggesting a review in fourth quarter. This additional retained capital would help to increase their capacity to lend, as well as reserving for significant non-performing loans formation as borrowers

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struggle to make repayments. In the UK, Sterling depreciated to a multi-decade low versus the US dollar due to demand for reserve currency coupled against the UK's post Brexit economic frailty. Mirroring the monetary policy easing globally, the Bank of England materially reduced interest rates, cutting by 65 basis points to 0.10%.

In Japan, Prime Minister Abe announced an enormous stimulus package equating to 20% of GDP (Y108trillion) double the size of the package compiled in the GFC. The package includes cash payouts equating to Y6 trillion targeted at households and small to medium size firms. The stimulus comes on the back of deteriorating consumption trends post the implementation of a 2% rise in consumption tax at the start of October.

In Asia ex Japan, China suffered a sharp economic contraction in the first quarter, emanating from Wuhan, the epicentre for the outbreak of Coronavirus. The extensive city-wide lockdown was hailed as a success towards the end of the quarter, and is seen as the early example for appropriate lockdown duration. South Korea is also seen as a potential early indicator for best practice. Emerging Asia was impacted later in the quarter, and is expected to struggle to rebound as quickly, given the relatively less equipped healthcare system and economic impact particularly facing the commodity economies.

In commodity markets, crude oil prices fell drastically from the start of the year at $60/barrel to around $20 (WTI Crude Futures) on the back of a supply glut that resulted from the deterioration in relations between OPEC+'s primary producer Saudi Arabia and Russia, coupled with a short-term demand decline of up to 20-30%. Expectations for a longer-term supply side response may come soon given the associated budget pressures that arise from $20 oil price.

PERFORMANCE & ACTIVITY

The Amity International Fund fell -17.0% in Sterling terms, underperforming the FTSE World return of -15.95% by 107bps and finishing third quartile for the period. Style reverted to the long-run trend with MSCI World Value underperforming MSCI World Growth by 12.5% over the quarter. Additionally, our overweight allocation to mid and small-cap companies was a headwind with falls at an index level of 25% and 21% respectively. In contrast, large-cap equities benefited from liquidity and flight to safety falling only 15.5%, with significant contribution from the mega-cap FANGs in the US market.

At a regional level, there was relatively modest variation between regions with Japan, a marginal underweight allocation the best performing region down 11%, with our holdings significantly outperforming falling only 3.9%. Our key underweight to the US fell c.14.1%, a little less than index, with our holdings falling in-line with the broader fund. The fund's 10% overweight allocation to Europe ex UK hurt modestly as the index fell 17.9%, although the fund's holdings outperformed falling only 14%. The primary negative allocation effect came from our 10% overweight to UK equities, with the UK fairing significantly worse than peers falling 24.2%, with the depreciation in Sterling vs. US Dollar adding to the performance disparity. Finally, Asia ex Japan returned 15.8% at index level, supported by China falling only 3.8% in GBP terms. Our underweight allocation to China and financials exposure in Singapore and HK were headwinds.

In terms of sector allocation, the largest positive contribution came from our zero exposure to the Energy sector which fell almost 40% in the quarter due to the supply/demand dislocation. Financials were the second worst performing sector, falling c.25%, with our underweight allocation being offset by a greater decline in our financial holdings which fell 32%, led by Dutch bank ING, which lost over half its value whilst also deferring dividends following regulatory recommendations. Basic Materials saw the fund's strongest selection impact, with holdings falling only 8% against the broader sector decline of 23%, led by resilience from our Swedish specialist packaging manufacturer BillerudKorsnäs and Norwegian based specialty cellulose maker Borregaard. The fund's largest overweight sector allocations had contrasting performance. Technology remained relatively resilient down only 6% with our holdings fractionally weaker, while the fund's other key overweight sector Industrials suffered a 20% fall with the holdings falling 24% led by Australian waste recycler Bingo Industries which fell 39%, having been the strongest positive contributor last quarter.

In terms of individual stocks, the strongest positive contributor was Swiss-based Roche Holdings, which rose almost 13%, with the company exhibiting strong leadership by developing and receiving emergency FDA approval for testing for COVID-19. Another top ten holding that rose during March was Nintendo, which gained 3% as consumers globally purchased the company's latest gaming platform for entertainment during the lockdown. In a similar vein, Tarena, the China based vocational educator, continued its rebound rising 112% during the quarter, with the ongoing management restructuring being supported by increased demand for online vocational courses delivered during China's prolonged lockdown. Other stocks that rose over the period included Microsoft, which gained 7.3% as the company experienced strong demand for its cloud based products, specifically its meeting function, Teams, and Ericsson which gained over 3% as demand rose for additional telecom equipment to support prolonged remote working and network data-loads. In terms of negative stock contribution, ING was the worst performing holding falling 53% as outlook for European lending deteriorated, coupled with regulatory recommendations to withhold dividends. This measure was put forward despite significantly stronger capital ratios, as banks will be required to deploy these retained funds to provide much needed credit to businesses over this transitionary period. The second most negative contribution at stock level came from not holding Amazon which gained 12.7% over the period, with the company benefitting from being the primary online retailer during this lockdown. Added to not holding Apple, another mega-cap FANG outperformer, contributed an 80bps headwind to performance.

In terms of fund activity, the primary activity has resulted from an extensive evaluation of the inherent leverage in our portfolio's holdings against the backdrop of the global macro deterioration, ensuring our portfolio consists of companies that can weather the crisis and participate in post-virus recovery. We paid particularly close attention to balance sheet strength, debt distribution profile, credit ratings, debt covenant headroom and cash-flow generation. The key switch was within the medical technology sector with the Fund exiting Zimmer Biomet and reinvesting in peer Boston Scientific. While both companies had fallen similar magnitude year to date, largely reflecting their higher than average net debt/EBITDA ratios, Zimmer Biomet has significantly greater exposure to deferrable elective surgery, equating to c.83% of sales, while Boston Scientific's exposure is broadly less than 10%. With most healthcare institutions deferring non-urgent procedures for six months, with the potential for extension should there be a further pandemic wave, we felt the switch into a more innovative, resilient and diversified product mix was an appropriate given the circumstances and attractive valuation. Additionally, in mid-February, we reduced our exposure to Medtronic materially due to strong performance. Within industrials, we sought to reduce our exposure in early March by taking profits in Bingo Industries, reflecting the full valuation and previously exhibited sensitivity to construction markets. Within the UK insurance sector, we initiated a well-timed switch from RSA into Legal & General, with the latter looking significantly better value and in significantly better shape than the previous financial crisis.

OUTLOOK

The outlook for the global economy has arguably never been so opaque. Political leaders face an unenviable task of balancing the medical assessment of the virus' retracement trend and potential for re-emergence of second waves, against the urgent need to restore some economic and social activity. The recent peaks in infections and deaths reflect the extraordinary measures taken to lockdown society, and hence it remains to be seen how quickly the virus will re-establish itself once a degree of normality resumes. While those countries first impacted from the crisis, such as China and South Korea, offer early insights into this conundrum, it remains too early to draw reliable conclusions with consumer activity in China still substantially below normalised levels. With medical experts suggesting the formulation, manufacturing and distribution of vaccine will be up to 12 months away, a cautious scenario would appear to suggest normal economic activity, such as extensive cross-border air travel, could be on a similar time frame. Historical precedent from previous pandemics, suggests we might get several false starts, reflecting the potential for future waves, as well as the unprecedented act of starting the economy suffering from the fallout of an economic stop.

From a valuation perspective, earnings estimates are yet to reflect the impact of the economic stop, with most companies announcing the withdrawal of both 2020 earnings guidance and increasingly a deferral or outright cancellation of any dividends and buybacks.

Given that management teams are facing such opacity regarding when economic activity will resume, it is understandable their reluctance to project demand and future revenue, never mind their ability to further assess the impact of operational leverage has on overall earnings. However, as first quarter earnings season approaches towards end of April, an assessment of initial damage to balance sheets will be more easily quantifiable, and we can remove a further degree of uncertainty. While the priority remains ensuring the liquidity and solvency of portfolio holdings to ensure all are likely to participate in the post-crisis economic recovery, using historical valuations and peak-to-trough analysis from previous crisis can provide a framework for assessing value. The primary positive has been the speed and efficacy of Central Bank policy, implying the likelihood of market malfunction has been substantially reduced. As long-term investors, looking beyond the immediacy remains key, which implies assessing the likelihood for second waves when lockdown conditions are eased, and beyond that assessing what a post-crisis global economy looks like with high levels of debt prevailing in all sectors, not just government, but many corporates and consumers. With that in mind, we continue to adhere to our bottom-up, stock-picking process, searching for sustainable and responsible companies with strong cash flows, robust balance sheets and healthy long-term growth outlooks that are trading on attractive absolute and relative valuations.