Q3 2020 COMMENTARY
AMITY INTERNATIONAL FUND

QUARTER TO END SEPTEMBER 2020

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	2.52%	22.10%	3.07%	13.41%	66.99%	91.79%
FTSE World TR GBP	3.22%	23.78%	5.24%	29.67%	96.35%	197.96%
IA Global	4.08%	24.20%	6.76%	26.25%	83.74%	149.53%
Sector Quartile	3	3	3	3	3	4

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

REVIEW

Following on from the sharp rebound in the second quarter, global equity markets delivered a modest positive return during the third quarter of 2020, supported by central banks continued accommodative monetary policy measures, signs of economic recovery and further progress with vaccine trials. Overall, the FTSE World Index climbed 3.2% (on a total return basis, in sterling terms), taking year-to-date gains to 4.1%.

In the US, the recovery in the domestic economy continued, with the Federal Reserve's (The Fed) messaging remaining highly accommodative. In an attempt to signal a longer-term accommodative stance, the Fed will now use average inflation targeting in setting the policy interest rate, allowing for temporary overshoots in inflation. Further evidence was found in the Fed's latest policy rate projection (the "dot plot") which suggests that policymakers see rates at zero through to the end of 2023. The justification of such loose policy can be seen in the US unemployment rate which despite dropping to 8.4% in August from 10.2% in July, remains exceptionally high and expected to remain high until the virus subsides and large portions of the service sector can return to work. With further fiscal stimulus appearing on the horizon, Q3 saw significant gains for the US equity market, which rallied 8.9% over the period in local terms, however the stimulus-related dollar weakness tempered gains for sterling-based investors to 4.7%.

European equity markets rose a modest 1.5%, underperforming the broader global benchmarks, as signs of an economic slowdown developed as the quarter progressed, as COVID-19 infections returned to several countries, notably France and Spain. Deteriorating economic sentiment prevailed as newly announced restrictions to contain the virus were announced. In terms of stimulus packages, the European Union (EU) approved the €750 billion fund to help member states recover from the pandemic. The fund will be made up of €390 billion of grants and €360 billion of loans to be distributed among member states, and which will be borrowed by the European Commission. The proceeds will be used to reach the EU's objectives of climate neutrality and digital transformation, as well as offering social and employment support and reinforcing the EU's role as a global player.

In the UK, the return of a potential disorderly "Brexit" weighed on investor sentiment during the quarter, coupled with concerns around the implications of a second wave of COVID-19 infections towards the end of the period. Rising infection rates led to the re-imposition of restrictions in certain parts of the country following similar measures taken by several nations in continental Europe. The number of people on furlough has declined from c.30% at the peak to c.10% of jobs at the start of September, although concerns remain regarding the potential for equivalent fiscal support should pandemic restrictions extend through winter. Consequently, the UK equity market fell by 4.2% over the three-month period (on a total return basis, in sterling terms), materially underperforming global equities. However, the index return somewhat masked the divergence in the performance of the underlying groups, with both the FTSE 250 Mid-Cap Index and the FTSE Small Cap Index delivering positive returns. On the positive side, the second quarter of the calendar year reporting season witnessed increased corporate confidence with many companies resuming guidance on their anticipated financial performance for the rest of 2020. Additionally, a number of corporations resumed the payment of dividends which had been deferred prior to the AGM season, at a time of peak uncertainty.

In Japan, the quarter was somewhat dominated by the resignation of Shinzo Abe as prime minister, due to the resurgence of a long-standing health problem, just four days after he recorded the longest continuous term of any Japanese prime minister. Following his resignation, a close

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ally, Yoshihide Suga, who occupied the role of Chief Cabinet Secretary, quickly emerged as the frontrunner and he duly won the Liberal Democratic Party's (LDP) leadership election, and hence was confirmed as new Prime Minister shortly after on 16th September. The relatively well-managed transition is expected to see a continuation of Abenomics, which paired with a corporate quarterly earnings season that brought more positive surprises than anticipated, helped deliver Sterling return of c.2.4% for Japanese markets over the quarter.

In Asia, there was pronounced regional disparity with significant parts of emerging Asia continuing to suffer from pandemic related impacts. In India, COVID cases continue to rise with daily cases in excess of 100,000, while Thailand continues to suffer from a lack of tourist income. Despite the recurrent trade war rhetoric, Chinese economic data signalled an ongoing recovery, coupled with signs of normal work patterns returning illustrated by subway traffic down only 10% from pre COVID levels. Overall, the broad weakness in the US Dollar helped Asian markets in aggregate outperform the broader global benchmark rising 4.5%.

PERFORMANCE & ACTIVITY

The Amity International Fund rose 2.5% in Sterling terms, modestly below the FTSE World return of 3.2% in the third quarter, finishing third quartile for the period. Style variance continued on trend despite expectations for a value rally to be led by further economic stimulus, with MSCI World Value index returning -0.2%, underperforming MSCI World Growth by 7.4%, as the latter rose 7.1% over the quarter. Year to date, MSCI World Value index has fallen 9.9%, while MSCI World Growth has delivered a total return of 25.2%. This 35% underperformance has continued to be driven by a combination of ultra-loose monetary policy, coupled with the COVID-19 accelerating digitalisation, which in aggregate can favour growth orientated businesses. Additionally, the increased demand for responsible and sustainable strategies is leading to a re-rating of credible companies in this universe. Overall, this dynamic is unlikely to change, given the long-term positive outlook for sustainability, relative finite investment opportunity set and increased scrutiny of holdings through improved corporate disclosure and the establishment of agreed taxonomy structure.

At a regional level, the primary allocation headwind came from the overweight to the UK, which continued to be the worst performing region, falling 4.2% at index level, with the Fund's holdings modestly underperforming, down 1% more.

The Fund's overweight allocation to Europe (ex UK) contributed modestly due to the region appreciating only 1.5%, however the Fund's holdings gained 5.8%, outperforming by 4.2%. The underweight allocation to the US was a minor headwind as the index rose c.4.7%, driven again by the Technology and consumer sectors, making it the top performing region. In Japan, the Fund's holdings again outperformed the benchmark, rising 5.8% against the 2.4% benchmark, driven predominantly by Nintendo which gained 22.2% in the quarter. Finally, in Asia (ex Japan) the Fund's holdings modestly outperformed with a total return of 5.9%, versus the 4.5% total benchmark return led by TSMC which gained over 35% during the third quarter.

In terms of sector allocation, the largest positive contribution came from Basic Materials sector, with the Fund's holdings rising almost 21% against 6.5% for the sector. This was driven primarily by Norwegian bio-refiner Borregaard, the provider of sustainable biomaterials to replace oil-based products, which rose 37.5% following strong results. The Consumer Goods sector was also a positive contributor during the third quarter, led by the Fund's holding in Adidas, which gained 18.2%, enabling a return of 11.1% vs. the broader sector of 7.5%. One of the largest positive contributions came from not owning Oil & Gas exposure, as the sector suffered a 15% fall. Avoiding bellwethers such as Exxon (-25%) and Chevron (-21.8%) continued to be a relative positive, although with the sector's index weight falling to only 3.0%, the impact is more diminished. The Fund's overweight allocation to Industrials sector contributed positively with the sector rising 6.6%, however the Fund's industrial holdings gave back some of last quarter's outperformance, rising only 3.0%. Renewable energy cable producer Prysmian, which gained c.47% in Q2, continued to perform strongly rising a further 20% in the third quarter. The company announced an innovative trial with Dutch telecom provider KPN to produce a significantly reduced diameter cable from 90% recycled plastic enabling a significant reduction in raw material use. Meanwhile the UK's decision to expand its offshore wind capacity from 30GW to 40GW is expected to see further increase in cable demand for these connections. The Fund's overweight position to Technology was positive with the sector returning 7.0% during the third quarter, however the Fund's holdings rose only 3.5%. Similar to last quarter, not holding Apple was the second largest detractor at a stock level as the company gained over 21% on continued optimism around consumer demand. The primary detractors in the technology sector were Cisco Systems, which fell 19% following disappointing earnings and Nokia which fell 14% on news the Finnish government were building a stake to block any potential takeover. In terms of positive earnings updates, Salesforce released exceptionally strong earnings, resulting in 28% gain for the quarter, while the outlook remains particularly bullish. Finally, TSMC (+35%) continued to demonstrate its unrivalled capabilities at leading edge nodes of 5nm.

In terms of fund activity, we initiated a new position in Bruker, a leading global manufacturer of high-end analytical and scientific instruments used within academic and clinical diagnostic end markets. Bruker effectively enables scientists to develop solutions within cutting-edge life science fields including genomics, proteomics and nano-analysis. Additionally, within the healthcare sector, we increased our exposure to Cerner, where we see the company creating significant system efficiency gains at a time when healthcare budgets are becoming larger and under increasing pressure to be efficiently deployed. Within the Industrials sector we continued to add to our holding in Biffa, which later in the quarter demonstrated its circular economy capabilities with an agreement to recycle and reprocess all of Nestle Waters UK (Buxton) plastic bottles. Additionally, within the industrials sector we added to our holding in Valmont, which later in the quarter announced an agreement to produce the largest connected, efficient irrigation solution on the planet in Africa. The strong rebound in markets led to pockets of over-valuation, and we used this volatility to sell-down exposure in favour of more attractively valued long-term holdings. During the quarter, we sold out of our holding in Dechra Pharmaceuticals largely on valuation grounds with the stock now trading on close to 35x June 2021 earnings. Additionally, we trimmed several of our holdings following strong performance, including animal nutrition leader DSM, Nintendo, as well as Adidas.

OUTLOOK

With global benchmarks barely changed from year-end levels, it would be fair to expect that the majority of the longer-term uncertainties that have developed since the COVID-19 outbreak to have been resolved. However, instead of improving visibility, the over-arching driver has been excess liquidity, with central banks globally implying almost unlimited monetary policy support whenever necessary. From an equity market perspective, this excess liquidity has divorced valuations from underlying fundamentals, inflating risk-assets to levels that imply minimal tail-risks from resurgent infections or persistently impaired employment markets. Taking a cue from fixed income markets, 13 out of the largest 20 developed market indices trade at P/E multiples three turns higher than this time last year (i.e. 19x vs 16x). Whilst there are over 100 COVID-19 vaccines in development, ultimately until one is shown successful, approved and manufactured at scale, the outlook will remain relatively opaque with higher than average tail risk. Until then, there remains the need to continuingly assess the likelihood for second waves as lockdown conditions are eased.

While digital orientated business models have thrived, COVID-19 is expected to accelerate the structural decline in a number of other sectors such as traditional retail, while key elements of the service sector will likely continue operating substantially below full capacity for the foreseeable future. While only accounting for around 5% of GDP, the travel and leisure sector accounts for c.10% of overall employment. We remain concerned regarding the potential for unemployment to remain stubbornly high, with companies assessing how to manage their cost-base, or face administration as we have seen already in this past quarter. For now, central banks and governments have provided a temporary safety economic net, with estimates of over $16 trillion added to the global debt stock. Given this issuance, the chance of interest rates rising before 2022 looks very low, while in the longer term, the neutral rate of interest, will be closer to 2% than 4%, due to debt servicing constraints.

Overall, the myopic outlook for markets is dominated by two interlinked factors – COVID-19 and the arrival of short-term fiscal stimulus. The depth and breadth of the current pandemic remains unknown and largely determined by the success of short-term containment measures, and further out, successful identification, trial and manufacture of an effective vaccine for COVID-19. Several credible vaccine trials have been progressing, implying that 1Q21 for approval and 2Q21 for manufacture may be a feasible timeline. Clearly, positive news on this front in the coming months would be significant for investment markets, not just absolute levels but the shape of the market would likely shift from favouring digital enablers to the more economically sensitive laggards.

In the intervening period, with monetary policy having seemingly reached a natural limit to its problem solving capabilities, the focus is firmly, and rightly, on how any tailored fiscal packages can support most affected sectors. Globally, initiatives such as guaranteeing subsidised business loans, providing grants to small and medium sized businesses as well as underwriting the private sector wage bill, will be required to avoid substantial business closures and permanent impairment of employment markets. With respect to short-term outlook, the announcement of further fiscal stimulus is likely to act as a temporary floor on equity markets. That said, the longer the economic stops persist, the higher the risk of persistent damage to the economy, the lower the willingness and ability of bond markets to digest the resulting surge of issuance and soaring indebtedness ratios.

Looking at the final quarter of a challenging year, two key political event look material with the US election on November 3rd, and the culmination of Brexit at year end. In the US, the electorate's assessment of President Trump's handling of the crisis has appeared to have deteriorated based on early October polls, with the market increasingly discounting the probability that Democrats win both the House and Senate. Aside from making effective legislation easier to implement, it would be more likely that Democrats could pass their green infrastructure bill, as well as re-join the Paris agreement on climate change. Overall, it seems fair to expect increased stimulus led investment into sustainability solutions both in the US and Europe. As ever as long-term investors, looking beyond the immediacy remains key, and 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.