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Aviva Investors
Global Equity Endurance Fund

Giles Parkinson, Fund Manager

FEBRUARY 2020

February Commentary – The Art of Execution

Fund Overview

The Fund seeks to achieve resilient returns over the long term by investing in a high-conviction, low turnover portfolio of 'cheap endurables', predictable cash generative businesses acquired at attractive cash-based valuations.

Monthly Performance

- The fund fell by -9.7% in February; the MSCI All-Countries World Index fell by -8.1% in the month.
- The index return benefitted from an estimated +2.4% rally on Wall St the last trading day of the month after the SICAV's 3pm London-time valuation point that is not reflected in our February returns. A popular index tracker, the Blackrock World Equity Index which importantly has the same valuation point as the Endurance SICAV, fell by -11.0% over the period.
- Since inception the cumulative monthly capture ratio of the Fund has been 1.5, with an average upside capture of 99% and downside capture of 68%

Month in Review

Equities tagged an 'all-time-highs' in February before retracing sharply on recession fears.

Given the market volatility in the latter days of the month we will dispense with the usual practice of discussing top/bottom contributors to performance. In general, the Endurance portfolio performed resiliently. Instead, we will describe what we did, which was a lot, as unitholders should expect after periods of strong relative returns as we attempt to preserve the Cheap Endurable integrity of the fund.

During the early part of the month we added a little to existing position Bid Corp, which declined on fears over the short-term impact from Australian bushfires on supplying restaurants, and our holding in Kone, which dropped what we regarded as an unjustifiable amount after it lost out in the auction to acquire ThyssenKrupp's elevator business. In the middle of February, we began to be concerned about the rapid gains being made in the NASDAQ and some of our more growth-orientated holdings. We elected to sell most of the holding in Danaher (went from 3.0% at the end of January to 0.6% at the end of February), trim S&P Global and Moody's (by a total of 1.5%), and sell out of Microsoft (2.3%, described below). Some of this cash was invested in existing holdings First Republic, Comcast, and St James's Place. As the market declined at the end of the month we initiated a new holding in Hubbell (ended the month at 1.7%). We find it interesting that except for Comcast all of our purchases were mid-caps and smaller large-caps whereas our sales were large- and mega-caps. One of the advantages of being a global investor is that 'there is always something to do' and it is at times like this that years of accumulated knowledge about businesses and a cashflow-driven view of fundamental valuation will hopefully pay off as we seek to take advantage of the price opportunities that the market offers us.

Fund managers frequently like to pitch stocks but assessing a 'hit rate' – what proportion of stocks picked go on to outperform the market – is only the beginning of the story. Instead of what to buy, we are more interested in *when* to buy, *how much*, and *when* to sell: in other words, the art of execution. Inertia analysis compares the hypothetical returns from the starting-period portfolio against the actual returns and can be used to assess whether active trading decisions add value. Size analysis compares the hypothetical returns from an equally weighted portfolio against the actual outcome to judge whether position sizing is accretive to returns. Liking a stock isn't enough: did you buy a lot of it at the best possible time and hang on to it for as long as it outperformed? How much money you make when your right is essential for converting a hit rate into runs on the board.

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Take Microsoft for example. The stock wasn't held at inception of the fund but it is one we had owned previously in our career. In mid-2018 we shook ourselves out of our torpor and bought the stock around $100, on a trailing P/E multiple of 27x and EV/fcf ("Enterprise value to free cash flow" – think of this as the ratio between the debt-adjusted market cap and cash flow distributable to shareholders) yield of 3.7%. Sometime in the latter half of 2019 we began to lose confidence that the stock was a Cheap Endurable. The shares closed out the year at $158. Earnings had grown 47% such that the trailing P/E multiple was not very different at 29x. However, the cash story had slipped, with training free cash flow up only 18%, such that the EV/fcf yield had dropped from 3.7% to 2.3%. (For simplicity we are ignoring dividends and share buybacks as immaterial). In other words, the 58% price return since our purchase was driven by multiple expansion rather than growth, and the former tends to be more mean-reverting than the latter.

But we didn't sell. Mindful of trying to make as much money as we can when we are right, and in view of the ultra-liquid nature of the stock, we elected to institute a rolling stop loss to govern the timing of our exit, which was triggered in the third week of February. On a short-time horizon, we estimate this execution approach enabled up to make an additional 20% on the position than would have otherwise been the case.

Looking Ahead

The Global Equity Endurance Fund is a portfolio of what we believe to be above-average businesses trading at a cheaper free cash flow yield than the market and a discount to their intrinsic value. A combined focus on the durability of a company and the price we pay for the stock enables us to exploit opportunities and ought to make the approach adaptive to changing market conditions. As a long-term strategy with low turnover we fully expect and recommend that unitholders judge our performance over a period of five years or more.

Key Risks

The value of an investment and any income from it can go down as well as up and can fluctuate in response to changes in currency and exchange rates. Investors may not get back the original amount invested.

Certain assets held in the Fund could be hard to value or to sell at a desired time or at a price considered to be fair (especially in large quantities), and as a result their prices could be very volatile.
The Fund Invests in emerging markets, these markets may be volatile and carry higher risk than developed markets.

The Fund invests in a small portfolio of securities. Losses from a single investment may be more detrimental to the overall performance than if a larger number of investments were made.

The Fund uses derivatives; these can be complex and highly volatile. This means in unusual market conditions the Fund may suffer significant losses. In unusual market conditions, the Fund may have difficulty selling its investments, which may cause it to suffer losses, defer redemption payments or suspend dealing in shares.

Investors' attention is drawn to the specific risk factors set out in the fund's share class key investor information document ("KIID") and Prospectus. Investors should read these in full before investing.

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The Prospectus and Key Investor Information Document (KIID), are available, together with the Report and Accounts of the SICAV, free of charge from Aviva Investors Luxembourg, 2 rue du Fort Bourbon 1st Floor.L-1249 Luxembourg, Grand Duchy of Luxembourg R.C.S. Luxembourg B25708, Aviva Investors, St Helen's, 1 Undershaft, London EC3P 3DQ or relevant office below. The Prospectus is available in English and German. Where a sub fund of the SICAV is registered for public distribution in a jurisdiction, a KIID in the official language of that jurisdiction will be available. The Prospectus, the KIIDs, the Articles of Incorporation as well as the Annual and Semi-Annual Reports are available free of charge in Austria from Raiffeisen Bank International AG, Am Stadtpark 9, 1030 Vienna the paying agent and in Switzerland, from the representative and paying agent BNP Paribas Securities Services, Paris, succursale de Zurich, Selnaustrasse 16, 8002 Zurich, Switzerland. In Germany, The Paying and Information Agent in the Federal Republic of Germany is Marcard, Stein & Co AG Ballindamm 36 20095 Hamburg, Germany. In Spain, copies of the Prospectus and KIID together with the Report and Accounts are available free of charge from the offices of distributors in Spain. The UCITS is authorised by the CNMV with registration number 7. You can also download copies at www.avivainvestors.com. Aviva Investors Global Services Limited, registered in England No. 1151805. Registered Office: St Helen's, 1 Undershaft, London EC3P 3DQ. Authorised and regulated in the UK by the Financial Conduct Authority and a member of the Investment Association.

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