

# Gradually, then suddenly

GQG Partners Global Equity Fund



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*"Marge, I can't wear a pink shirt to work. Everybody wears white shirts. I'm not popular enough to be different."*

– Homer Simpson, *The Simpsons*<sup>1</sup>

During a year in which everything making headlines seems to have the word "ever" at the beginning of it, maybe we should have titled this piece "Eveready" instead of paying homage to Hemingway's 1926 novel *The Sun Also Rises*. However, we think that "Gradually, Then Suddenly" encapsulates far more about markets than something with "ever" in the title.

To spare everyone a book report, there's a passage in the novel where Hemingway's character Mike is asked how he went bankrupt. He replies with the famous title of this letter: gradually, then suddenly. This idea, that the stage is set in the past for the events today, isn't novel (no pun intended), but this should serve as a perpetual reminder that history didn't start yesterday.

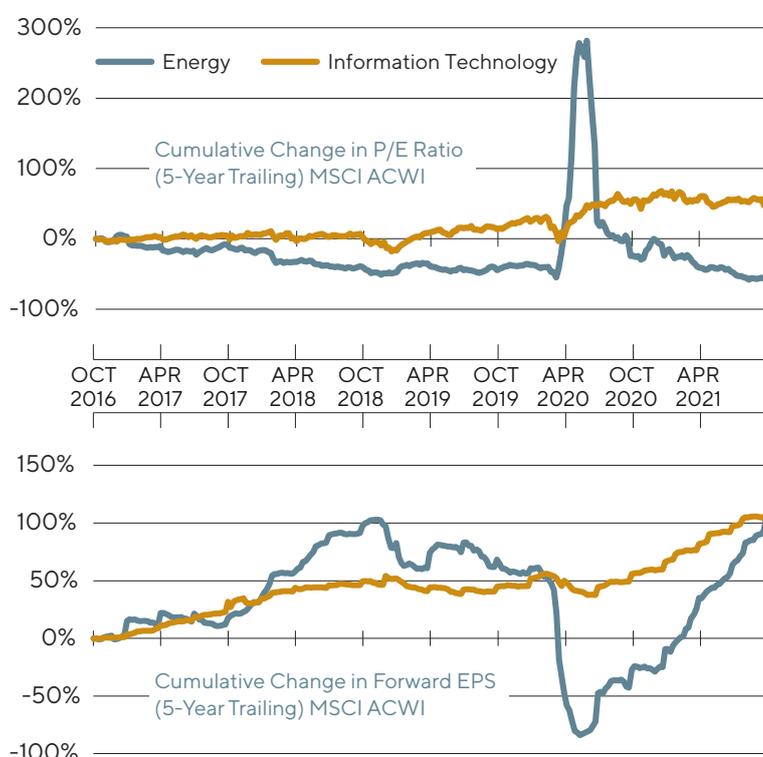
Recall that in our first quarter commentary we discussed how the giant ship *Ever Given*, which was stuck in the Suez Canal, was a good proxy for surprises. For all the discussions over the years of potential blockages of the world's most famous canal, a giant ship getting stuck in the mud didn't really hit the meaningful part of the probability distribution. Fast-forward to September 2021 and the phrase du jour is "China's Lehman Moment," which as you likely know involves the highly indebted Chinese property developer Evergrande (there's that word again).

Now, in our view, it's highly unlikely that this is, in fact, "the big one" for a whole host of reasons. Because data is best used as an ensemble, we simply don't see the degradation of a variety of market metrics – regional equity declines, currency devaluations, a meaningful increase in non-property-based borrowing costs, etc.— that would suggest to us that *contagion* is here. However, this does not suggest that there are no problems afoot and that everything is all clear. To see this, we believe all one has to do is look at our China exposure (or lack thereof) in our non-US portfolios to see how we have expressed this lack of earnings certainty. Despite this, our perpetual refrain still holds that we follow the data. And as the data changes, we will strive to adapt.

We continue to believe the argument holds water that China is still a growing consumer market and there are still great opportunities to make money. However, the onslaught of regulatory actions over the past ten months has hurt many investors outside China - and, in our view, dampened the attractiveness of this market, no matter how attractive these policies are to those in China. Under President Xi, China seems to be moving away from a market-driven economic model to one that pays more attention to social stability and common prosperity in an effort to narrow the large and growing wealth gap. Hence, we believe it becomes a more challenging task for foreign investors to pick and choose where to invest in China in today's environment.

**EXHIBIT 1: COOKING WITH GAS**

Forward Price-to-Earnings (P/E) ratios and growth rates as earnings per share (EPS) of the MSCI ACWI Energy and Information Technology sectors over the last 5 years.



Source: Bloomberg as at 30 September 2021 for forward P/E ratios and EPS of the MSCI ACWI Energy and Information Technology sectors since 1 October 2016. **PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.** You cannot invest directly in an index.

lot these days). But it's worth bringing up today, given current comparisons to the 1970s, in understanding where we are and how growth and inflation impact portfolio decisions. As many of you may know and have heard us say many times, our mantra is rooted in preparation, not prognostication. While it's certainly true that our exposure to more cyclical areas of the market has increased across our portfolios throughout 2021, this was not a "call" on commodity prices, rates, GDP growth, etc. Rather, it was simply an analysis of the overall opportunity set where our forward-looking quality approach uncovered what we believe are a wider array of attractive companies, as highlighted in Exhibit 1, where we compare forward price-to-earnings (P/E) ratios and growth rates as earnings per share (EPS) of the MSCI ACWI Energy and Information Technology sectors over the last 5 years.

This also is how, when you look at the portfolios, overall prices paid have come down without sacrificing quality or compound growth too much, something we highlighted in the first quarter.

To further underscore this point, let's use one last ever-based word, and this time, let's look at "evergreen." While headlines often dominate *current* conversations, it's important to keep this whole business of "history not starting yesterday" straight. Because we know that things often rhyme, we believe history has repeatedly shown that it's rarely, if ever, the biggest or loudest event that everyone is focused on that causes the most heartburn. No, generally it's much more innocuous than that, with major events sounding more like a thief in the night than the cacophony of things emitting from a construction site.

With this evergreen concept in mind, and our Homer Simpson quote in hand, let's examine a couple of topics that we have been spending a lot of time thinking about and where we're quite comfortable being different – growth and inflation.

**FOLLOW THE DATA**

Much like we wanted to spare you the book report on Hemingway, we also will spare the economics lesson, as well as all of the details of the Phillips curve and the alleged trade-off between unemployment and inflation (something we seem to be dealing with quite a

So what does all of this have to do with growth and inflation? Well, first of all, we don't need to wade into whether or not this is transitory – Google Trends can help you with that, and hint: the search activity peaked around June. Additionally, by the strict nature of the word, we believe everything is transitory because everything is temporary. But let's view our current predicament through the lens of our bottom-up process and take a look at the recent earnings release of a company taking the pulse of global trade and commerce: FedEx. A few quotes from their Q1 2022 corporate earnings call should suffice:

The continued constrained capacity in both the U.S. domestic and international markets has led to a **very favorable pricing environment**. As announced yesterday, **effective January 3, 2022**, FedEx Express, FedEx Ground and FedEx Home Delivery **shipping rates will increase by an average of 5.9%**, while FedEx **Freight rates will increase by an average of 5.9% to 7.9%**. We also announced other surcharge increases, which can be found on [fedex.com](https://www.fedex.com).

As we look to the rest of the fiscal year, **we expect certain factors to extend longer than we originally forecast in June**.

Overall, for the second quarter, **we anticipate a similar level of headwinds in Q2 as we experienced in the first quarter** as the challenges and impacts to our operations from the labor **shortages are expected to persist through the rest of calendar 2021**. Consistent with the first quarter, we also expect headwinds in Q2 to be driven by our expansion of Ground, higher health care expenses, COVID-related air network inefficiencies at Express and the benefit in the prior year of reduced aviation excise taxes.<sup>2</sup>

If FedEx is raising prices, how likely are they to give discounts next year? If they're at the center of shipping and trade, yet they can't "forecast," how accurate are the forecasts likely to be of others further removed from the value chain of stuff? None of this is about doom and gloom; none of this is about predicting an imminent collapse of anything – but it does behoove us as investors to ask the questions and understand where expectations may be a bit off (something we highlighted in our second quarter commentary). What if the more important signpost for investors isn't Chinese property but US-based delivery services? What if margins shrink or growth estimates are too rosy? What tends to happen to the longest duration spectrum of the equity market if *current expectations* around transitory costs become not so transitory and expanding margins and increasing multiples were to suddenly stop? Let's examine another example, but this time at the opposite end of the FedEx spectrum: rapidly growing software.

Atlassian Corporation is a rapidly growing, Australia-based software company offering a wide array of productivity-enhancing products. The company has grown revenues at ~35 per cent per year for the last five years and now has more than US\$2 billion in revenue<sup>3</sup>. Now let's assume that the company kicks it into high gear and can grow revenue at 70 per cent next year, then 50 per cent the following year and 30 per cent for the remaining three years before we apply a terminal multiple of 8x price-to-sales. Sounds pretty good, right? If this scenario were to occur, and we quite like this company by the way, investors that bought at the end of September 2021, with a market cap around US\$95 billion, would actually *lose* money as the discounted market cap would be around US\$90 billion. Very few companies, as far as we can tell, have been able to maintain such high revenue multiples once revenue growth approaches US\$10 billion (something that would occur near year five in our scenario).

Despite being a fantastic business in our view, how confident can we be in these projections? Generally, when  $n=1$ , or  $n$ =very few, it's unlikely that estimates are to hit the middle of the distribution. Great companies, as you all may know, can still be overvalued. In our opinion, those companies with the fastest growth, and which have continued to become increasingly more expensive in price, are the most vulnerable to a shift in expectations. As we like to say, better to miss up than miss down. So once again, it's not surprising to see our portfolios with lower levels of more expensive, growth-type names.

Therefore, unlike Homer Simpson, we're fine with wearing pink shirts when our more growth-oriented peers are wearing white. We believe our forward-looking quality approach and growth through the lens of compounding allows us to shake off the 3x5 card of allowable style box opinion (something of which we're happy to remind folks) and focus on where we believe we have the highest degree of earnings certainty over the next five years.

We do agree that many things are transitory, but we don't agree that we can ignore the current ensemble that suggests many things are not.

## GQG PARTNERS GLOBAL EQUITY FUND

### EXHIBIT 2: MANAGED FUND TOTAL RETURN PERFORMANCE IN AUD

PERFORMANCE SUMMARY AS AT 30 SEPTEMBER 2021	1 MO	3 MOS	YTD	1YR	3 YRS	SINCE INCEPTION (5-JUL-17)	2020	2019	2018
Fund – A Class gross of fees %	-3.34	3.35	20.87	12.91	15.50	16.81	6.58	27.13	12.11
Fund – A Class net of fees %	-3.40	3.16	20.19	12.07	14.58	15.85	5.72	25.99	11.11
MSCI ACWI ex Tobacco %	-2.99	2.85	18.72	26.50	12.74	12.99	6.05	26.87	0.98
Difference net versus benchmark bps	-41	+31	+147	-1,443	+184	+286	-33	-88	+1,013

The performance data quoted represents past performance. PAST PERFORMANCE is not a reliable indicator of future performance. Current performance of the Fund may be lower or higher than the performance quoted. The investment return and principal value of an investment will fluctuate so that an investor's units, when redeemed, may be worth more or less than their original cost. Returns greater than one year are annualised. Returns are presented both gross and net of fees and are based on end of month redemption prices assuming the reinvestment of all distributions and capital gains. Gross performance is calculated after the deduction of actual trading expenses and is net of taxes withheld on foreign dividends, interest and capital gains. Net performance is calculated in same manner as gross performance but also deducts the stated management fee, which includes management and other administrative fees (custody, legal, admin, audit and organisation fees). There can be no assurance that the Fund will achieve its investment objective. The performance data contained herein is calculated by a data provider whose calculation methodology may result in Fund performance that is lower or higher than the performance quoted in Fund reports.

During the third quarter of 2021, the GQG Partners Global Equity Fund outperformed the benchmark MSCI ACWI ex Tobacco (AUD) USD by 0.31 basis points net of fees, posting a total net of fees return of 3.16 per cent versus the benchmark's 2.85 per cent return (see Exhibit 2).

Among the largest contributors to relative performance during the quarter were stock selection in Communication Services, an underweight to China and an overweight to the Energy sector.

The largest negative contributors to relative performance during the quarter were an overweight in Brazil, stock selection in the Materials sector, and an underweight to Japan.

### EXHIBIT 3: TOP FIVE MANAGED FUND CONTRIBUTORS & DETRACTORS BY HOLDING FOR 3Q 2021

TOP CONTRIBUTORS BY HOLDING AS AT 30 SEPTEMBER 2021	AVERAGE WEIGHT %	CONTRIBUTION TO RETURN BPS	BOTTOM CONTRIBUTORS BY HOLDING AS AT 30 SEPTEMBER 2021	AVERAGE WEIGHT %	CONTRIBUTION TO RETURN BPS
Alphabet Inc	7.2	+70	Vale SA	2.6	-81
Novo Nordisk A/S	2.4	+45	Banco Bradesco SA	1.0	-26
Blackstone Inc	2.4	+41	Petroleo Brasileiro SA	1.8	-11
Devon Energy Corp	0.7	+40	Volkswagen AG	1.7	-10
Microsoft Corp	4.8	+38	Taiwan Semiconductor Manufacturing Co Ltd	2.2	-9

Source: Northern Trust for the three months ending 30 September 2021. Portfolio holdings are subject to change without notice and are Australian dollar-weighted based upon the total net assets of the portfolio. The holdings identified and described do not represent all securities purchased, sold, or recommended for inclusion in the Fund and no assumption should be made that such securities or future recommendations were or will be profitable in the future. There are 100 basis points (bps) in one per cent.

**CONTRIBUTING HOLDINGS OVER THE THIRD QUARTER INCLUDED:**– **ALPHABET INC**

Alphabet dominates the online search market with Google's global share above 80 per cent, through which it generates strong revenue growth and cash flow. In our view, Google's ecosystem strengthens as its products are adopted by more users, which was aided by the pandemic, making its online advertising services more attractive to advertisers and publishers and resulting in increased online ad revenue. During the quarter, the company benefited from elevated consumer online activity and broad-based strength in advertiser spending.

– **NOVO NORDISKA/S**

With almost 50 per cent market share by volume of the global insulin market, Novo Nordisk is the leading provider of diabetes-care products in the world. During the quarter, the company reported robust top-line growth off the back of strong global demand for its GLP-1 diabetes and obesity therapies.

**DETRACTING HOLDINGS OVER THE THIRD QUARTER INCLUDED:**– **VALE SA**

Vale is the world's largest iron ore miner and a key supplier to the global steel industry. During the quarter, the company was negatively impacted by volatile iron ore prices which had a peak to trough decline of over -50 per cent. This elevated level of volatility in the underlying commodity price may be attributed to China curbing steel output in hopes of meeting its carbon neutrality goal by 2060 as well as jitters associated with Evergrande and by a possible downtick in overall steel demand.

– **BANCO BRADESCO S.A.**

Banco Bradesco, together with its subsidiaries, provides various banking products and services to individuals, corporates, and businesses in Brazil and internationally. Brazil's currency and stock market came under pressure during the third quarter amidst rising political tensions.

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**DEFINITIONS**

**Earnings per share (EPS)** is the monetary value of earnings per outstanding share of common stock for a company.

**Price-to-earnings (P/E)** is the ratio of a company's share price to the company's earnings per share.

**Price-to-sales (P/S)** is the ratio of a company's stock price to its revenues.

## END NOTES

1. "Stark Raving Dad," *The Simpsons*, season 3, episode 1, directed by Rich Moore, written by Al Jean and Mike Reiss, aired 19 September 1991, on the Fox network in the United States.
2. FedEx Corporation, FedEx Q1 FY2022 Earnings Call Transcript, 21 September 2021, [https://s21.q4cdn.com/665674268/files/doc\\_financials/2022/q1/Earnings-Transcript-Q1FY22.pdf](https://s21.q4cdn.com/665674268/files/doc_financials/2022/q1/Earnings-Transcript-Q1FY22.pdf). Emphasis by GQG Partners.
3. S&P Capital IQ (object name Atlassian Corporation Plc (NasdaqGS:TEAM) > Financials > Income Statement; accessed 5 October 2021). Data by subscription only.

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