Global Equities Update

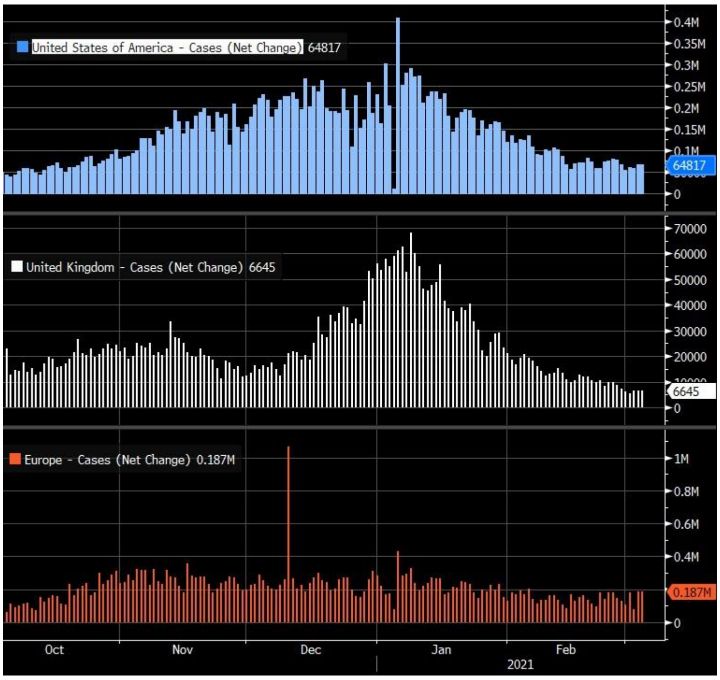
February 2021

This report has been prepared by Northcape Capital, the underlying investment manager for the Warakirri Ethical Global Equities Fund.

Market Review

The MSCI World index finished the month up 2.5% in USD or +1.6% in AUD terms as the recovery rally continued with Covid vaccines rolling out and case numbers continuing to decline. There was also supportive economic data in the form of strong US retail sales (+5.3%) and US Industrial Production (+0.9%) in January, both well ahead of expectations. In a somewhat Goldilocks scenario US Fed Chair Jerome Powell commented that the US economy still has a long way to go before reaching maximum employment and the Fed's inflation target, so still needs support. Whilst in Europe, it was more mixed as a number of countries were extending lockdowns, there was some support as the European Parliament gave the go ahead for the €750bn Recovery and Resiliency Plan.

Daily Covid Cases US, UK and Europe



Source: Bloomberg

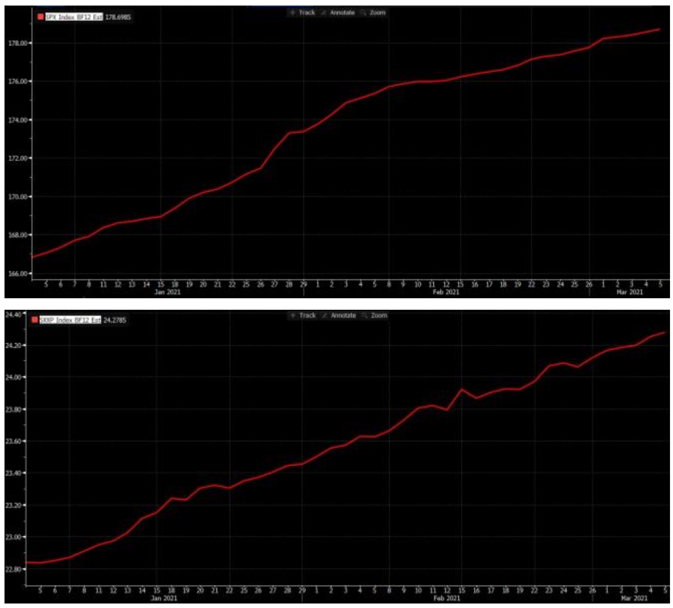
Volatility and gold fell, US and European interest rates rose and curves steepened as the market started to price in a more exuberant economic outlook. The impact was twofold, firstly, recovery plays, cyclicals and financials that benefit from higher rates performed well and secondly, longer duration and higher PE, or no "E" and 'Meme' stocks underperformed, although notably are still a long way from where they were a year ago! Interestingly also, valuation mattered little - of the cheapest MSCI world sectors, two were the best performing (Energy and Financials) and two were the worst performing (Utilities and Healthcare) sectors over February.

Goldman Sachs Non Profitable Tech Index

Source: Bloomberg

Looking at the stock fundamentals we can see further rationale for the markets' exuberance via earnings forecasts, which continued to be revised up through the month as results were reported, albeit at a slightly slower pace than in January – S&P500 EPS was revised up 2.5% during February versus 4.2% in January. Euro Stoxx 600 EPS was revised up 2.8% in February following a 2.9% revision in January.

S&P 500 and Euro Stoxx 600 Index 1 year forward EPS estimates



Source: Bloomberg

News Flow

February was a big month for earnings reports. We discuss Nvidia and Unicharm in more detail below.

Nvidia (United States)

Another quarterly beat and (monster) raise for Nvidia, as we have come to expect. The two engines, Gaming and Datacenter, continue their growth trajectory. Gaming, with the added benefit of crypto currency, had another strong sequential growth quarter and grew 67% organically y/y. Datacenter, with Mellanox included, was flat sequentially. The other smaller segments delivered as expected, with a rebound in the Covid-impacted Professional and Auto segments. The revenue guidance for Q1`was 18% ahead of consensus on a revenue basis, but the sell-side continued to nit-pick on the flat sequential guidance of Datacenter and the potential unsustainable impact of crypto. EPS numbers went up 10% for the next fiscal year, but surprisingly the stock was down 8% on the day. As a result, the NTM P/E ratio dropped more than 10 turns and is back in the low 40's. Whilst this might seem high (and is the likely reason for the share price fall) we feel very comfortable that continued, very strong growth is achievable and hence the stock will be able to grow into this multiple over time.

Unicharm (Japan)

Japanese nappy and sanitary product manufacturer, Unicharm delivered another strong set of results with defensive growth (+3.7% FX neutral in Q4) and continued improvement in margins. Guidance was for higher growth (6.9% sales CAGR) mid-term as it expands into the growth areas of Feminine Care, Adult Incontinence and Pets, in particular in China, and sees a recovery from Covid in markets like India and Indonesia which were hurt when product usage fell as consumers stopped going out. The PE has pulled back to ~35x which looks reasonable given its defensive/uncorrelated nature, strong market position and long runway for growth in Asia as it has products that can cater to babies for India and Indonesia's growing populations and adult diapers and pet care products for the ageing populations and increased pet ownership in China and Japan.

Outside of results reports we met with Hoya, Colgate, SAP, Visa and ASML from our Approved List. We also heard from some interesting companies not on our Approved list such as Microsoft, Chipotle Mexican Grill, Clorox, Kone and Legrand. Whilst Microsoft needs no introduction, it is impressive how it has reinvented itself for the cloud and continues to grow, spurred on by Covid. Chipotle is a largely US based Mexican fast casual restaurant business. The concept of healthy and fresh fast food has taken off in the US and the company think they can more than double the number of units over time. Longer term they are also excited about growing International. Whilst the remaining three companies are very different and not household names, it is very likely that you are using their products every day! Clorox has dominant market positions in niche markets or product areas, including Glad, Brita and Burt's Bees. Kone is one of a handful of global escalator and elevator companies, deriving half its sales from installation and half from recurring maintenance and modernisation services. Lastly, Legrand manufactures switches, fuses and other electrical devices which your electrician would likely install as you upgrade and modernise your home or work. These are the types of quality businesses with structural growth drivers and high levels of profitability which we will look to add to our Approved List over time so we can then buy them when valuations are attractive.

In terms of future holdings, we note the increasing likelihood of a continued strong bull market. With Covid vaccinations increasing and cases declining, we are seeing signs of increased demand for travel and entertainment. At the same time, we note that household savings are very high and governments are still pushing forward with stimulus programs.

The Warakirri Global Equities Fund is long only, low turnover, concentrated and benchmark unaware. As such it will typically hold up to 40 stocks. These stocks will come from a concentrated Approved List based on Northcape's research of around 60-75 selected stocks from global developed markets which comprise of resilient companies with enduring quality characteristics that are typically within attractive industries.

For more information, please contact us on 1300 927 254 or visit warakirri.com.au