TRANSCRIPT: EPISODE 202
14 July 2022 (pre-recorded 5 July 2022)

Below is a transcript of the episode, modified for your reading pleasure. Please check the corresponding audio before quoting in print, as it may contain small errors. Please remember we've been discussing individual companies to bring investing to life for you. It's not a recommendation to buy or sell. The fund may or may not still hold these companies at your time of listening. For more information on the people and ideas in the episode, see the links at the bottom of the post.

[INTRODUCTION]

Staci West (SW): Welcome back to the Investing on the go podcast brought to you by FundCalibre. Despite the negative headlines for Europe in recent months our guest today remains positive on the region and shares his insights into investing on the continent.

Ryan Lightfoot-Aminoff (RLA): Hello I'm Ryan Lightfoot-Aminoff and today I'm joined by Chris Garsten, manager of the Elite Rated Waverton European Capital Growth fund. Chris, thank you much for your time today.

Chris Garsten (CG): Thank you.

[INTERVIEW]

RLA: Now you remain positive on the what you're calling the COVID cyclical recovery stocks. Could you just maybe talk us through what you mean by this and maybe an example of one of these socks and why you remain so positive on it?

CG: Yeah. Well, COVID really challenged a lot of companies. They were either hit by demand disruption or supply disruption and we took the view that challenges equal opportunities. And if I break those two groups down into two, so on the demand disruption, these were companies like healthcare where suddenly people couldn't go to hospital. And so there's a huge backlog of cancer treatment cases, or the airports where people couldn't travel anymore. But the companies then did a lot of cost cutting. So we feel over the medium term, the earnings potential of that group will be higher in the coming years than it was pre pandemic.

But it also hits a lot of companies on supply side. On the demand was fine, but there was a supply upset. So it was either congestion in the ports, or we all know about the semiconductor shortage. And so if I just take an example here the semiconductor shortage really benefited the car companies because for the first time in living memory demand was greater than supply because people had money in their back pockets, but the car companies simply couldn't produce enough cars. So their profitability went through the roof, but for the poor old car component suppliers, it was a very different story because they had to grapple with fairly soggy volumes. They had very short production runs as the car companies continually changed their production plan. And they had to absorb a lot of the raw material price increases because they're on annual contracts. So they had to absorb the steel price increases and the aluminium and the chip prices and the goodness knows what, and so for them it's a very different story.

And we like a company called Autoliv, which does seat belts and airbags. And they've got half the global market for airbags, and we think they'll recover strongly. And indeed people say the there's about 30 million cars of pent up demand in the system. And when you look at US auto stocks, I mean, they're virtually zero. Car dealers have got no cars on their forkfuls, which is very unusual.

RLA: Thank you. And one of the other things you've said is that you've long believed that there's a correlation between ESG and good performance from companies. Are you seeing more opportunities come through in that respect to positive ESG attitudes or the decarbonisation in Europe? Or are some of the, sort of the headwinds to the ESG trades. such as the increased oil price and the subsequent benefits, have they also taken some of the wind out of that trade?

CG: Well, the one thing you can say with great certainty is that Europe is the leader in ESG and decarbonisation. And this whole area has received a boost with the rise in oil and commodity prices.

But ESG is very complicated and it is actually full of contradictions. And so whilst unquestionably our investment process leads us to find the ESG winners it’s not a straight line. And I'll just give you an example. There's been some talk about the EU taxonomy framework. Now taxonomy is a fancy word for classification. And basically what the EU is trying to do is

create rules for which investments or classifications for which investments are sustainable and which aren't. And if you are deemed sustainable, you should get more capital flows.

Now that sounds brilliant, but there's only one mining representative on the EU board. So the EU has decreed that mining is not sustainable and therefore should not receive capital flows, but copper is good if you then change copper into electric motors, which help to decarbonise the world. So you've got this really weird situation that you're not allowed to mine copper, but you are allowed to use it.

And so what we did is we looked at a Swedish company that mines copper because they do it in an extremely environmentally friendly way. They have a very low carbon footprint in global terms. And not only that, they do it in a very safe way. They've had no fatalities for the last 14 years and for a company their size, statistically, you should have a fatality every one or two years, because it is a bulky business. And as it happens, they happen to be AAA rated by MSCI. So, you know, we invested in them pre Ukraine. And then obviously with Ukraine, they've got a big boost, but it was that we don't religiously follow whatever the taxonomy/consensus thinking is, we come to our own conclusions and we try and avoid the crowded trades because those are the ones that are highly rated. And they're the ones that have to earn off the high ratings.

RLA: No, absolutely. Thank you. And you touched on a Swedish company there, and we have seen that you've got quite a significant amount in the Nordic region, particularly Sweden and also Finland. What is it about the region that you like so much?

CG: Well, what we like about it is that successful management teams have to wear a number of hats and basically it's four. They have to invest in their employees, to make sure that they're fully trained and motivated. They have to invest in their production process, whatever that is either manufacturing or IT. If you're a financial company, the third hat is to keep the regulator happy. And finally they need to keep an eye on shareholders to make sure they're well remunerated.

And we think that the Scandinavian/Nordic region gets the balance of those four very, very well. So you know, they do all, they keep them balanced, but I could just say, as an aside that we do also like Switzerland. We don't have much there because it's an expensive stock market but they are great strategic thinkers. So for example, Nestle went into pet food long before it became fashionable and Rush, for example, bought into PCR technology. Two years ago, none of us have

heard of PCR, but basically now we all know what it is, it's a gene photocopier. Anyway, they bought into the rights in 1991 for $300 million. And since then they've had over $30 billion of sales from the product, you know, great acquisition, great forward thinking. And we do hold Nestle. We have had Rush in the past.

RLA: Well, thank you. And now sort of taking a step back and looking sort of at Europe as a whole, how worried are you about recession in Europe and the fact that sort of one policy of interest rates really won't help some of the countries in the Union. So Germany and Italy, very different economies, very different drivers, exposed very differently to interest rates. Is there sort of a possibility that Europe could be fragmented further? Are you concerned about sort the Euro crisis 2.0?

CG: Yeah. There are two questions there really aren't there. First of all, about recession and then the impact it will have. On the first one of recession. Yes, we are worried. I mean, for example, gas prices in Europe are seven and a half times those of the States. And of course, if Putin gets really nasty and cuts off the gas, then that's gonna have a big knock on effect. And also, I think sort of globally, what we're worried about is that you know, with interest rates, having been so low for so long, that's created all sorts of distortions.

And so we're quite worried about what I have to say, our friends in the asset management business have done, they've gone into all sorts of alternatives. That probably seem good at the time, but with hindsight may not have been so interesting, but also some areas have had huge investments, and I'm thinking here of semiconductors. And so what we're trying to do is we are trying to keep out the kind of bubbled areas and go more into the areas that we're less consensus to be in. And history tells me that the less consensus you are the better you will hold up in a difficult market.

In terms of your second question about the periphery. I mean, again, you know, very valid question and it does look vulnerable, Italy's et al benefited enormously from the ECBs net negative interest rate policy and will probably require some kind of help from the ECB on that front through their stability mechanism.

But we mustn't forget that there's a lot of political will for the Euro to hang on in there. And there's a lot of human and social issues underpinning this. And I think it's very unlikely that the

Euro will disintegrate. And the analogy I like is a rather old one, so forgive me if you've heard it before, but joining the Euro is a bit like putting milk in coffee, that it's very easy to put the milk in, but once it's in, it's mighty difficult to get it out. And you know, I think it's a valid comparison.

But if the Euro were disintegrate, which is not our core thinking, there would be mayhem in the financial sector. But I think the kind of manufacturing companies that we've got a big buzz too, they would sort themselves out pretty quickly. So say for example, you're a German manufacturer, what would happen is that the core Euro would go up a lot in value because you'd have the weaker countries out of it, but then their share prices in the revalued Euro would fall somewhat. So net you'd probably be somewhat up. And I say somewhat up, because when the Swiss Franc revalued a few years ago, that is what happened, the Frank went up more than the Swiss shares fell.

RLA: Absolutely. And then again, Ukraine situation we've touched on it earlier, but do you think that the war in Ukraine has strengthened Europe in other respects? We seem to have a more united front on the continent now they've got a sort of similar enemy in Russia. Do you think that's potentially could play to Europe strengths now?

CG: Yeah. Well, one area that has definitely benefited from the Ukraine situation is the defence sector. And what we always try and do is to take emotions out of the investment process. And so we had bought a couple of the stocks before the war broke out and our logic was threefold. One of which was that we felt the defence sector was scoring unjustifiably badly on ESG. The companies were very cheap and finally some had extremely interesting technology. In contrast, some other ones have very legacy systems and obviously we're not into them. So the sum of all that is that we have kept our defence exposure that we had before the war. They've gone up, but you know, the outlook has improved since the 24th of February.

RLA: Okay, thank you. And then sort, maybe bring it to a close and rounding the whole thing off, we've talked about quite a few negatives for Europe some positives. What would you say to an investor today if they're unsure whether or not it's to invest in Europe, what is the base investment case for the continent?

CG: Well, first of all, I would like to thank you for considering the region, because we have found over the years, a lot of people have a very closed view of Europe. You know, they don't like Brussels. They don't like the Euro, you know, it's bound to fail. And so just forget the region and go somewhere else. But of course like everything it's more nuanced than that.

So for example, since we launched the funds you know, Denmark's up sevenfold in dollar terms, that's almost up to the NASDAQ level. But you know, in other countries like Belgium, Portugal, and Ireland have delivered you a stunning zero return. So, you know, you've always got to try and be on the hunt for the winners. And all I can say after the correction, which has been quite significant already, down 20% year to date, the market certainly looks vastly more interesting than it did eight months ago. The dollar strength should help. And a lot of companies are you know, a lot more global, a lot more professionally managed than they were a few years ago.

And so all I'd like to do is just conclude by saying that we invest in great companies that just happen to be based in Europe. You know, they're either at the vanguard of the energy transition or just benefiting from headwinds turning into tailwinds. But the key thing is to pay close attention to the stock market rating, because the biggest headwind of all is a very high stock market rating, because at some point you have to earn it off. And if anything, doesn't quite go according to plan that's when you make a very serious loss.

RLA: Well on that note Chris, we're going to have to leave it there. So thank you very much for your time today.

CG: Well, thank you.

SW: Chris and his co-manager Charles Glasse have been running this strategy for over two decades and believe that only a third of European companies are run for shareholders. The fund focuses on finding these companies through reforming European businesses. To learn more about the Waverton European Capital Growth fund visit our website fundcalibre.com and don't forget to subscribe to the Investing on the go podcast, available wherever you get your podcasts.

Please remember, we've been discussing individual companies to bring investing to life for you. It's not a recommendation to buy or sell. The fund may or may not still hold these companies at

the time of listening. Elite Ratings are based on FundCalibre’s research methodology and are the opinion of FundCalibre’s research team only.