SARASIN

Q4 2023

HOUSE REPORT

HIGHER FOR LONGER

Finding value in bonds

- **AI could be good for your health**
- **Notes from the Road: first-hand insights from our investment team**

INTRODUCTION

STEPHEN ROTHWELL

EDITOR

Welcome to the Q4 edition of the House Report

A new mantra – 'higher for longer' – can be heard on the lips of central bankers as they prepare us for an extended period of elevated interest rates. The precarious balancing act of taming inflation without triggering a recession is proving to be a more protracted task than many (ourselves included) could have anticipated.

With this economic backdrop, we place specific focus on the bond markets in this edition of the Sarasin House Report. As our Chief Market Strategist Guy Monson notes, bonds are beginning to offer attractive real yields for long-term investors.

Viewers of Guy's regular Six Minute Strategy videos will know that we have been selectively adding to corporate bond exposure for some time. Could now be the moment to make further allocations to government bonds too?

Delving further into the factors driving bond markets, Chief Economist Subitha Subramaniam explains how we arrived at today's high inflation, high interest rates and high debt levels, and why we may be about to rediscover the power of the bond vigilantes.

The intersection of healthcare and artificial intelligence (AI) is a rapidly developing arena which has the potential to deliver huge societal and financial benefits. Alex Hunter outlines how advances in AI could radically speed up drug discovery and diagnostics, and impact complex areas such as cancer and dementia. The tantalising prospect of a significant AI-driven burst of innovation and growth in healthcare and pharmaceuticals could offer exciting opportunities for investors.

At Sarasin we believe there is no substitute for thorough fundamental research. First-hand insights gained from face-to-face meetings with company management are a valuable component of our research process. In our Notes from the Road section, we share highlights from recent visits by members of our team to a diverse mix of companies in the US and Asia.

We hope you enjoy this autumn edition of the Sarasin House Report and that it provides some useful insights into our thinking and your investments. As ever, we welcome your feedback, so please get in touch with any comments or suggestions at housereport@sarasin.co.uk.

CONTENTS

GUY MONSON
CHIEF MARKET STRATEGIST
& SENIOR PARTNER

View from the
Chief Market Strategist

FINDING VALUE IN BONDS

A higher-for-longer environment

> Despite the sharpest interest rate rises in 40 years, core consumer prices remain high.

Bringing inflation to heel without triggering recession is getting harder. Bond markets are starting to price in the risks.

The rise in yields across global bond markets last quarter brought home a reality that many had long suspected. Namely, that letting just enough air out of the world economy to reduce inflation without triggering recession is a difficult and drawn-out process.

Despite the sharpest interest rate rises in 40 years, core consumer prices remain high. In the US and Europe the measure is still more than twice the central banks' 2% target. In the UK it is more than three times.[1] Central bankers may not raise rates much further, but they are still a long way from cutting them.

The 'higher for longer' mantra for rates has been repeated by the Federal Reserve (Fed), the European Central Bank (ECB) and the Bank of England (BoE) over the past two months. The bond markets appear to be listening. Ten-year US treasury yields climbed more than 0.7% over the third quarter to 4.5% (the highest since 2007), while in the eurozone yields rose by about 0.45%.

Even Japanese bond yields climbed after the Bank of Japan relaxed its yield curve control programme. Interestingly, one market that proved relatively defensive was UK gilts, where yields stayed at around 4.4%, after a sharp sell-off earlier in the year.

Matterhorn or Table Mountain?

It's important to remember that a 'higher for longer' strategy is not the norm for central banks. When rates peak, they talk of patient and gradual cuts, only to slash them aggressively once recession appears on the horizon. Indeed, bond traders have an old adage that interest rates 'take the stairs up and the elevator down', an observation borne out in almost every slowdown since the early 1970s (see Chart 1).

This time, the world's central bankers seem determined to hold rates near current levels, at least until the second half of 2024. Huw Pill, Chief Economist at the Bank of England, recently described the traditional rate cycle as being like the Matterhorn: a long climb up and then a sharp descent. What we need today, he said, is something more like Table Mountain (he was speaking in Cape Town), where rates move up sharply but stay flat for a protracted time.

Federal Reserve Chairman Jerome Powell delivered a similar message at the Jackson Hole conference in August, saying the Fed would "hold policy at restrictive levels until we are confident that inflation is moving sustainably down toward our objective."

Beware premature victory celebrations

Such determined and unified policy statements are encouraging, because a recent study by the International Monetary Fund (IMF) shows that central bankers generally ease too early. After examining more than 100 inflation shocks in 50 countries, the authors concluded that in 60% of cases it took at least five years for inflation to return to target.[2] The policy failures came, almost universally, from central bankers' 'premature celebration' of success. Today's talk of 'Table Mountain' may be an honest reminder to investors that squeezing embedded service sector inflation out of the system will be a long job. The repricing of bonds to reflect this is beginning, we feel, to offer value.

Could higher oil prices re-energise inflation?

The second challenge for bond markets is the risk of a renewed inflation shock triggered by rising energy prices. Crude oil (WTI) rose by an extraordinary 24% last quarter but has fallen back sharply in recent days, at the time of writing. The driver for higher prices was supply cuts from OPEC+, coupled with unusually low inventory levels in the US. As ever, higher prices will trigger more supply: several non-OPEC+ nations, including Brazil, Guyana and the US, are poised to ramp up production. Russia is also lifting sales (ironically), as routes are found to avoid the G7 price caps and western sanctions.

While a squeeze higher in oil prices is possible, this run-up will likely be brief in the face of volatile supply and ongoing economic uncertainties, particularly in China. Politics will play a part too, with President Biden reluctant to see excessive price rises at the pump in an election year.

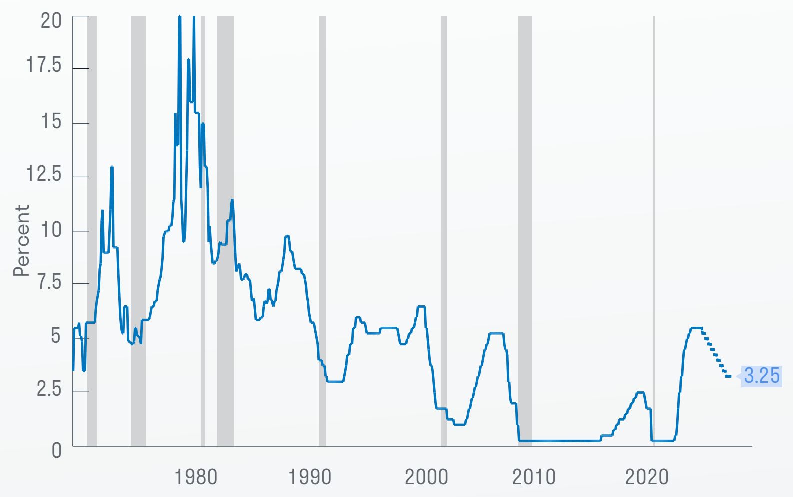
Unions demand a catch-up in real wages

A third challenge for bond investors is the unions' determination to recover the multi-year losses in real wages suffered by their members. In the UK we are still facing substantial wage demands from the health and rail sectors. In the US, the United Autoworkers Union (UAW) is, for the first time, striking at all of the three biggest US producers (GM, Ford and Stellantis). The UAW is demanding a 36% increase over four years, to catch up with past sub-inflation awards – and, they say, to emulate the pay rises enjoyed by their CEOs.

There are risks that the UAW action could spread to other industries, but we should remember that US unionisation is low. Membership has fallen from 20% of the workforce in 1983 to 10% at the end of 2022. US wage growth appears to be slowing, despite the strikes, from 6.7% in June 2023 to 5.3% and vacancies are also starting to fall.[3] Labour markets are still tighter than in the pre-COVID years and strikes could escalate, but there is evidence that conditions are easing.

CHART 1 RATE RISES: MATTERHORN OR TABLE MOUNTAIN?

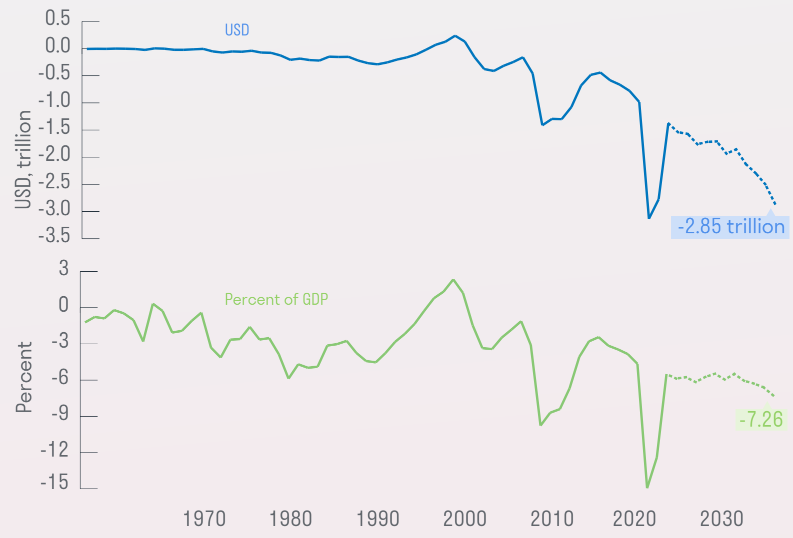
US INTEREST RATES AND RECESSIONS
SHADED BARS ARE US RECESSIONS



SOURCE: MACROBOND, OCTOBER 2023
PAST PERFORMANCE IS NOT A GUIDE TO FUTURE RETURNS AND MAY NOT BE REPEATED.

CHART 2 US BUDGET DEFICITS BALLOONING

UNITED STATES BUDGET DEFICIT (-) OR SURPLUS



SOURCE: MACROBOND, OCTOBER 2023
PAST PERFORMANCE IS NOT A GUIDE TO FUTURE RETURNS AND MAY NOT BE REPEATED.

Bond tsunami

The fourth and final challenge for bond markets comes from a surge in supply. The reasons for this are explained in greater detail by Sarasin's Chief Economist Subitha Subramaniam in this issue of the House Report in *Return of the bond vigilantes*?

The leading culprit for the surge in supply is the Biden White House and its gargantuan fiscal programmes. The American budget deficit is running at close to 6% of GDP (Chart 2), or nearly $2 trillion per annum, a level more often associated with wartime spending. To fund this already requires enormous treasury issuance. This is not unique to the US – France and Italy, for example, have also projected materially higher deficits.

Other culprits are the central banks, which are in the process of selling vast inventories of bonds that they accumulated during the COVID years and previous quantitative easing programmes. This year the Fed is expected to sell back almost $1 trillion of bonds to the banks and treasury markets. Together, US government bond issuance and the Fed's bond sales in 2023 will be equivalent to almost 13% of US GDP.

Daunting though this is, we must bear in mind that there is always demand for a true safe-haven asset, a US treasury, if the price is right. Today, with 10-year treasuries yielding 4.7% and US TIPS (inflation-linked bonds) delivering a guaranteed 2.4% above inflation for 30 years, rates are starting to look attractive. The more so, if inflation falls to something like the Fed's target of 2%.

Remember, too, that high issuance does not always result in higher yields. Japan has accumulated record debt relative to GDP, yet its bonds have consistently had among the lowest yields globally. In short, issuance is a concern, but if treasuries and other government bonds are priced correctly, there will always be demand.

Farewell, TINA

For much of the past decade, 'TINA' (there is no alternative) has been the norm for investors. With yields on bonds and cash close to zero, or negative in much of the eurozone, equities became the default asset class.

Today, with US and UK cash yields above 5% and government bonds above 4.5%, there are compelling alternatives, particularly if you believe that today's inflation targeting will ultimately bear fruit. I hope we have shown above that this is probable and that, despite the challenges we face, bond yields are starting to look attractive for longer-term investors.

We have already made some tentative additions to UK corporate bonds and will consider adding to government bonds and, potentially, to index-linked bonds over the rest of 2023. We do not expect to be lucky enough to pick the peak in yields but, if last quarter's turmoil continues, we will be opportunistic buyers on some of the darker days.

[1] All data in the article sourced from Macrobond, as at 30.09.23, unless stated otherwise

[2] IMF, One Hundred Inflation Shocks: Seven Stylized Facts, 15.09.23

[3] Atlanta Wage Tracker, data at 30.09.23

SUBITHA SUBRAMANIAM
CHIEF ECONOMIST

RETURN OF THE BOND VIGILANTES?

> "I used to think that if there was reincarnation, I wanted to come back as the president… But now I would like to come back as the bond market. You can intimidate everybody."

James Carville, Bill Clinton's campaign strategist, 1994

Governments are issuing high levels of bonds, just as central banks are keen to offload their loss-making bond holdings. Will the bond vigilantes ride back into town?

There was a time when bond markets wielded enormous power as guardians of the public purse. So-called bond vigilantes kept profligate politicians in check by pushing up interest rates. By the end of the 1990s even the US government started to run budget surpluses.

This changed at the turn of the millennium. First, the internet and globalisation dampened inflation before disconnecting it from the economic cycle. When the technology bubble burst in 2000, fears of a Japan-style deflationary trap gripped policymakers, who slashed interest rates.

The lessons from Japan's decades of low growth and disinflation appeared to be clear: policy had been too slow and too timid. So when a US real estate crash unleashed the global financial crisis of 2007-08, central banks were determined not to repeat Japan's mistakes. In coordinated moves, they slashed interest rates to zero and used aggressive bond buying programmes to bring about a faster recovery in demand.

The global hunt for yield hunt

In the wake of the global financial crisis, substantial and synchronised central bank bond purchases dramatically reduced the supply of safe assets in the global economy. At the same time, western manufacturers' efforts to slash costs by moving production overseas gathered pace.

The result was a glut in global savings caused by current account surpluses across Asia and a drop-off in investment demand in developed economies. With excess savings chasing increasingly scarce safe assets, a global hunt for yield sent interest rates ever lower.

These dynamics became so powerful that many governments were able to issue debt at negative interest rates to eager buyers (see chart 1) and by 2021 $18 trillion of global debt had negative yields.[1] The bond vigilantes might have become a footnote in economic history had it not been for the powerful economic shock delivered by the pandemic.

CHART 1 BOND INVESTORS ARE ASKING FOR MORE

SOURCE: MACROBOND, OCTOBER 2023
PAST PERFORMANCE IS NOT A GUIDE TO FUTURE RETURNS AND MAY NOT BE REPEATED.

RETURN OF THE BOND VIGILANTES?

Subitha Subramaniam, Chief Economist

Pandemic + Ukraine = critical juncture

In economics, critical junctures are big events that have the potential to materially alter the trajectory of the world economy. The confluence of Covid-19 and Russia's invasion of Ukraine will likely prove to be a critical juncture.

Firstly, the magnitude of these two shocks dramatically altered governments' willingness to increase their intervention in the economy. What started as temporary income support for people affected by government-mandated shutdowns metamorphosed into a longer-term industrial policy aimed at improving global supply chain resilience.

The result is an expanded role for the state that will be difficult to reverse. The US fiscal deficit is running at close to 6%, a shockingly large number for a peacetime economy. According to the Congressional Budget Office, fiscal deficits in excess of 5% will be the norm over the next few decades unless politicians shift course radically.

Moreover, with debt levels already high, the interest burden is starting to bite. The total interest cost of US federal debt is expected to reach $1 trillion this year. Both Republicans and Democrats appear to have abandoned any pretence of debt sustainability, forgetting that sustained increases in debt and deficits can swamp private demand.

Second, many businesses have used discombobulated supply chains as an opportunity to pass on price increases to households. Pent-up demand from the pandemic and accumulated household savings played an important role in stoking inflation, but dislocations in global supply enabled companies to shift their pricing strategies. They will be reluctant to relinquish this pricing power and may be more willing to raise prices if further disruptions occur.

> The confluence of Covid-19 and Russia's invasion of Ukraine will likely prove to be a critical juncture.

Third, central banks, who were accustomed to ignoring smaller supply shocks, misjudged not just the magnitude and persistence of the pandemic distortions but also the resilience of household demand. A tardy initial response has led to an aggressive catch-up in interest rates, and central banks have little room for error. To maintain their credibility and anchor inflation expectations, they will need to err on the side of caution: 2024's mantra 'higher for longer' is the corollary of 2021's insistence that inflation was 'transitory'.

Hoist by their own petard

Sustained higher rates have consequences for central banks themselves. The US Federal Reserve is paying 5.38% in interest on $5.5 trillion of liabilities (bank reserves and money market reverse repurchase agreements). At the same time, it is receiving interest income from assets that were acquired when interest rates were at rock bottom. Sizeable losses are being accumulated. Since September, the US Federal Reserve has run an operating loss that now exceeds $100 billion and could easily double in a year's time.

In addition, the sharp increase in longer-term yields mean that central banks' balance sheets are suffering substantial losses on the market value of bonds they hold. In the US, these losses stood at $1.1 trillion at the end of 2022; since then further interest rate rises will have increased this figure.

While the Fed accounts for unrealised losses as a 'deferred asset' with limited near-term impact, such losses will reduce their appetite for further balance sheet expansion. In other words, the 'central bank put' – the notion that central banks will ease policy to support markets at times of stress – cannot be relied upon.

In the UK, policymakers are facing up to the reality that crisis interventions carry a fiscal cost. Bonds purchased by the Bank of England in its quantitative easing programme are housed at an Asset Purchase Facility (APF) backed by the UK Treasury. Between 2009 and 2022, as bond yields fell, the APF transferred £123.8 billion of profits to the Treasury. As bond yields have risen from 0.5% in 2021 to over 4.5% this year the Treasury will need to make whole any losses at the APF.

Over the next three years, this is expected to cost the Treasury roughly £120 billion. It is no wonder that central banks are pushing on with bond sales to reduce their balance sheets even as yields rise.

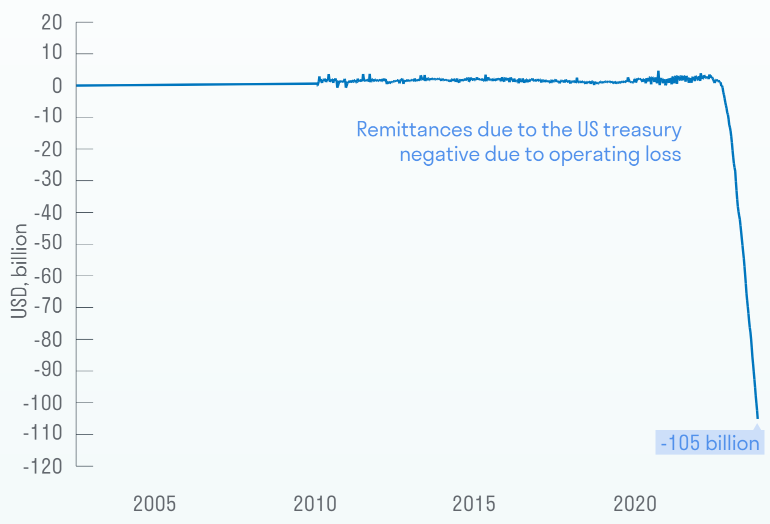
Where next for bond yields?

In the post-pandemic world, supply and demand dynamics in global bond markets have taken a markedly different tone. Governments are issuing bonds to fund ambitious fiscal agendas, with little regard for whether this is sustainable. At the same time, central banks, smarting from 'transitory' errors and mounting balance sheet losses, are withdrawing from their role as 'buyers of first resort'.

Given this shift in the balance of supply and demand, and uncertainty around inflation and policy risk, investors are demanding higher compensation. As Chief Market Strategist Guy Monson explains in our lead article, bonds are finally offering decent real returns – but investors should bide their time.

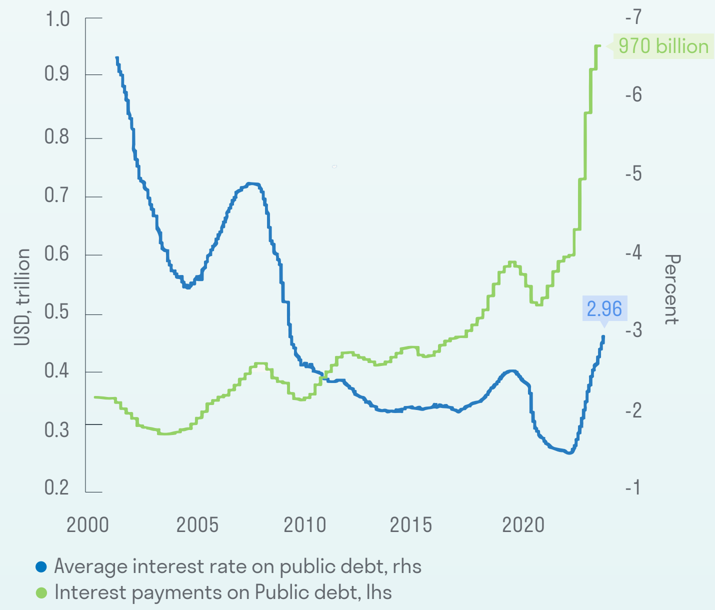
[1] All data in this article sourced from Macrobond as at 30.09.23

CHART 2 US TREASURY: REMITTANCES TUMBLE



SOURCE: MACROBOND, OCTOBER 2023
PAST PERFORMANCE IS NOT A GUIDE TO FUTURE RETURNS AND MAY NOT BE REPEATED.

CHART 3 ROCKETING INTEREST PAYMENTS ON US DEBT



SOURCE: MACROBOND, OCTOBER 2023
PAST PERFORMANCE IS NOT A GUIDE TO FUTURE RETURNS AND MAY NOT BE REPEATED.

ALEX HUNTER

PARTNER

AI COULD BE GOOD FOR YOUR HEALTH

AI could turbocharge drug discovery and diagnostics

"AI offers the tantalising prospect of a new phase of innovation in healthcare and pharmaceuticals.

Healthcare companies are surprisingly advanced in using AI to diagnose more accurately and speed up drug discovery. This could be the start of something much bigger and more beneficial.

Artificial intelligence (AI) has already proved its worth in some areas of healthcare, such as radiology, where it is used to carry out initial scan assessments and prioritise them for further analysis. This is an area where AI can excel – high-speed pattern recognition and an unflagging focus on detail – but there is much more that it could do.

Since 1970, healthcare stocks have outperformed the S&P Index and provided a mix of solid defensiveness and periodic bursts of innovation-fuelled growth. The 1950s and 1960s saw huge strides being made with small molecules, followed by the arrival of monoclonal antibodies in the 1980s and genomics from the 2000s onwards.

Like most advances, the genomics revolution (which is one of our investment themes) is taking longer to deliver its benefits than people expected after the initial sequencing of the first full human genome in 2003. At the same time, discovery of new drugs has become ever more expensive. Now, however, AI offers the tantalising prospect of a new phase of innovation in healthcare and pharmaceuticals.

Big pharma's drug problem

In the world of computing, Moore's Law notes that the number of transistors in circuits has doubled every two years as chip design and production improves.[1] This has enabled huge leaps in technological progress and vastly reduced costs for end users of digital wizardry.

Unfortunately, it appears the pharmaceutical industry labours under the reverse of Moore's Law – Eroom's Law. In recent decades the cost of developing new drugs has doubled every nine years.

A study from 2020[2] found that between 2009 and 2018 the median research and development (R&D) investment required to bring a new drug to market was almost $1 billion, with an average lead time of 10-15 years.

Pharma's increasing R&D bill coincides with mounting demand for treatments for ageing populations and conditions caused by sedentary lifestyles and ultra-processed diets. Many countries are having to pay more to provide healthcare and many individuals are having to pay more to access it.

Like finding a needle – in a stack of needles

Things could now be looking up for big pharma's drug researchers. Earlier this year, researchers at McMaster University and Massachusetts Institute of Technology (MIT) used an AI approach to identify an antibiotic specifically for Acinetobacter baumannii, one of the World Health Organization's most-unwanted dangerous antibiotic-resistant bacteria.

A. baumannii is a superbug usually found in hospitals. It can cause pneumonia and meningitis, can survive on surfaces for long periods and is also able to collect antibiotic-resistant genes from other bacteria.

Using AI, the McMasters/MIT team[3] sorted through thousands of potential antibiotic candidates in record time and at a fraction of the cost of traditional research methods. Testing and approval will be slower, but the team's success highlights the possibility of speeding up drug discovery and assessing the medicinal properties of, potentially, billions of molecules.

That was the easy stuff

As with pattern recognition in radiology, identifying antibiotics is a well-suited task for initial uses of AI in healthcare because it is well-defined, involving matching a specific enemy to its nemesis. By contrast, tackling cancer and dementia – two of the biggest areas of unmet medical need – is much more complicated. Humans are incredibly intricate biological machines: science is not even remotely close to understanding all the interactions involved in how our bodies function.

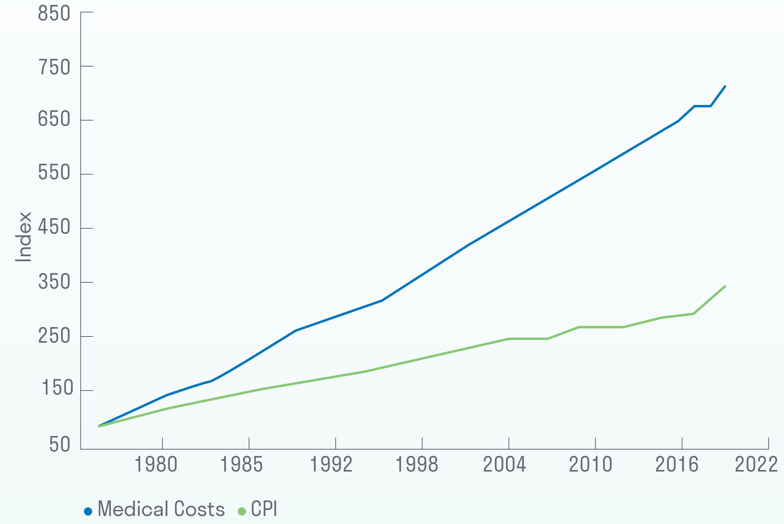
If AI can be brought to bear on complex areas such as cancer and dementia, the social and financial benefits would be enormous. Dementia alone imposes a brutal burden. Worldwide, it is estimated that around 55 million people live with dementia, implying annual care costs of $1.3 trillion.[4]

As populations in the US, Europe, Japan and China continue to age, these figures will rise dramatically. In the UK alone, the annual care costs of dementia are expected to rise from £34.7 billion to £94.1 billion by 2040 as the number of UK cases rises by 80%.[5]

Entering a rough patch, with optimism

The 2024 US presidential election could be a difficult time for the pharmaceuticals industry as Republicans and Democrats vie to get tough on drug prices in what is, by far, pharma's biggest market. Looking further ahead though, the sector's prospects could be much brighter.

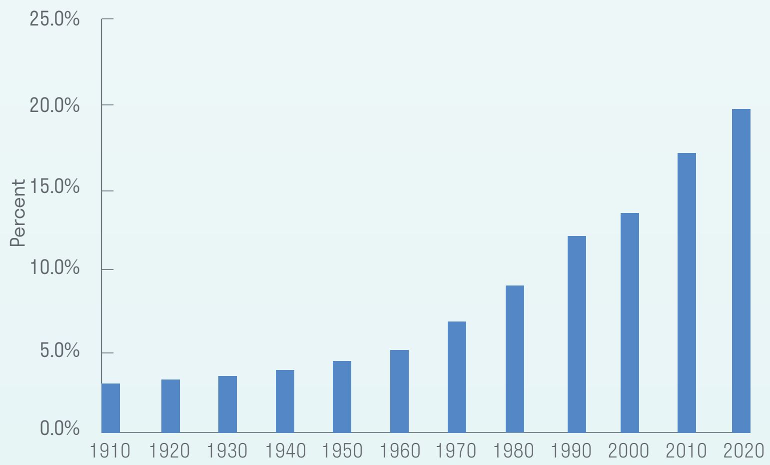
CHART 1 MEDICAL COSTS HAVE INFLATED MORE THAN 2X THE CPI SINCE 1980 (INDEXED TO 100)



SOURCE: CMS, BERNSTEIN ANALYSIS, 31.12.22

PAST PERFORMANCE IS NOT A GUIDE TO FUTURE RETURNS AND MAY NOT BE REPEATED.

CHART 2 NATIONAL HEALTH EXPENDITURE HAS GROWN SIGNIFICANTLY IN TERMS OF PERCENTAGE SHARE OF US GDP



SOURCE: BERNSTEIN ANALYSIS, 31.12.20

PAST PERFORMANCE IS NOT A GUIDE TO FUTURE RETURNS AND MAY NOT BE REPEATED.

Continued

COULD AI BE GOOD FOR YOUR HEALTH?

Alex Hunter, Partner

Following the Covid pandemic, some pharma companies have a high level of cash to deploy. The first six months of 2023 have seen a significant increase in acquisitions of bioscience companies by big pharma, including Pfizer's $43 billion proposed takeover of Seagen, which focuses on what is known as smart chemotherapy.[6]

> Applying AI to healthcare and pharmaceuticals offers the prospect of not only longer lifespans but also longer healthspans.

A shot in the arm for healthcare

We believe that AI could be highly advantageous for a number of companies that we invest in under our Ageing theme. These include Amgen, which has a strong data advantage over competitors thanks to its vast database of genetic samples. Using AI to analyse these could speed up the development of promising drugs while excluding less promising drugs at an earlier stage. Another example is Sonic Healthcare, which is likely to benefit from applying AI techniques to its diagnostic testing. This has potential to give Sonic Healthcare a competitive advantage over its many smaller competitors in terms of speed of diagnosis and cost.

Applying AI to healthcare and pharmaceuticals offers the prospect of not only longer lifespans but also longer healthspans (healthy life). In the process, it is likely to free up resources for more innovative therapies, creating a virtuous circle that could bring a step change in tackling the enormous challenges posed by ageing demographics.

1 https://www.britannica.com/technology/Moores-law, 28.09.23

2 Estimated Research and Development Investment Needed to Bring a New Medicine to Market, 2009-2018. Olivier J. Wouters, PhD, Martin McKee, MD DSc and Jeroen Luyten, PhD; March 2020

3 MIT News, Using AI, scientists find a drug that could combat drug-resistant infections, 25.05.23

4 The worldwide costs of dementia in 2019. From Alzheimer's & Dementia, published by Wiley Periodicals LLC on behalf of Alzheimer's Association, 2023

5 Projections of older people with dementia and costs of dementia care in the United Kingdom, 2019–2040 Care Policy and Evaluation Centre, London School of Economics and Political Science

6 Pharmaceutical Technology, M&A in pharmaceutical increased in Q2 2023, 16.08.23

NOTES FROM THE ROAD

BROOK HARRIS
GLOBAL EQUITY ANALYST

JEREMY THOMAS
CIO, GLOBAL EQUITIES

KWAI SAN WONG
GLOBAL EQUITY ANALYST

Highlights and takeaways from a selection of recent company visits

With global travel restrictions and pandemic dislocations now firmly behind us, Jerry Thomas, CIO Global Equities, and Analysts Kwai San Wong and Brook Harris have been back on the road to meet a diverse mix of companies in the US and Asia.

Face-to-face meetings with company management are a valuable complement to the fundamental research and ESG risk analysis that we carry out. They not only provide opportunities to see businesses in action; they also enable us to have one-to-one conversations and meet the personalities guiding the companies we invest in.

IN THE US CONSUMER WE TRUST

Brook Harris
Global Equity Analyst

In a hectic whistle-stop tour across the US, I met with 18 US consumer companies, including three that we hold under our Evolving Consumption theme: Home Depot, Disney and Colgate.

My most abiding impression was the confidence and optimism among company management. All bar one expect they will be well insulated against any downturn thanks to the robust health of their customers, with many expecting that the US economy will avoid a recession altogether.

The labour market came up frequently in conversation – with an interesting twist in the case of US auto parts distributor Genuine Parts. The reluctance of younger generations to follow their parents into family-run auto-parts businesses gives Genuine Parts opportunities to buy up these businesses and add them to its franchise.

Meanwhile, home improvements giant Home Depot spoke about plans to continue investing in its workforce to improve the customer experience, highlighting another common thread among consumer companies that rely on face-to-face sales.

Companies appear to have their supply chains back to normal after the ructions caused by Covid. Many are future-proofing themselves against disruptive events by diversifying their supply chains, with cosmetics company Elf Beauty highlighting their renewed efforts to diversify geographically to reduce reliance on factories in China.

The pandemic has also had some positive knock-on effects. The craze to acquire pets during lockdown has left companies such as Colgate (which makes pet food as well as household, healthcare and personal care products) and Freshpet scrambling to meet demand for pet food. Colgate is rushing to complete a new pet food facility designed to reduce costs by maximising automation – a long-term trend that we invest in under our Automation theme.

It was noticeable how empty US offices are, raising a question mark over their future. Some companies, such as Airbnb and DoorDash actively use remote working to solve labour shortages. Others are keen to make two or three days in the office the norm, but find that remote working is now well established and there is low appetite among workers to return to the office.

AN OPEN AND SHUT CASE IN HONG KONG?

Jerry Thomas
CIO, Global Equities

It was great to see Samsonite dominating the advertising space around me in airports and malls on my recent travels through China, which included a highly encouraging meeting with Samsonite management in Hong Kong.

Travel is back on the menu for Chinese tourists and business travellers, and Samsonite – one of our holdings under the Evolving Consumption theme – continues to benefit from post-pandemic reopening.

It also has considerable leeway to grow its prestige Tumi brand in Europe and Asia, with little direct competition. We are confident that as sales grow, the company will continue to reduce its debt levels, reducing the impact of higher interest rates to the benefit of shareholders.

The company is also receiving more interest from investors in mainland China thanks to Southbound Connect, which allows mainland China investors to access eligible Hong Kong shares. Along with other premium brands, such as Prada and L'Occitane, Samsonite offers a way for Chinese investors to access global growth and diversify their portfolios.

UNLOVED CHINA OFFERS LONG-TERM VALUE

Kwai San Wong
Global Equity Analyst

China has disappointed investors this year, with high hopes for a post-pandemic boom fading as China's economic challenges have become apparent.

Our meeting with Tencent was therefore a timely reminder that China has some outstanding companies that are available at low valuations because of the current level of sentiment towards Chinese stocks. For selective and patient investors, a number of Chinese companies offer attractive returns with strong thematic growth.

Tencent is a holding in many of our clients' portfolios under our Digitalisation and Evolving Consumption themes. Its core business of games, online advertising and fintech has seen margins improving from new products coming on stream – especially mini-games, short-form video advertising and AI tools. Furthermore, Tencent has the advantage of a good supply of the Nvidia H800 chips that it needs to make its AI ambitions a reality.

Several discussions touched on the practicalities of developing Chinese-language AI tools. A stumbling block is the relative lack of online Chinese-language material suitable for training AI models. This is not an issue that the English-speaking section of the internet faces. Translating English material into Chinese to train AI models also has its shortcomings, as I discovered when I sampled some recent AI tools and received unusual answers to my questions!

I took the opportunity to try out a robotaxi that was festooned with screens, cameras and sensors. These self-driving vehicles have undergone a lot of research and development and are being introduced to the general public. After a 45-minute journey through busy streets, my overwhelming impression was that the technology is ready but it will take time for regulators to be comfortable with a general rollout. Autonomous driving could be an example of a great innovation taking a lot longer to implement than people initially expect, but I have little doubt there will be real value in this technology for users and investors.

Bringing it back home

Disappointing recent growth in China and the most negative Chinese real estate indicators in 30 years[1] urge caution. However, investors should not overlook the region's world-class companies, a number of which have a bright future ahead of them. We recommend a highly selective approach to investing in China and economies that are closely tied to it.

Our discussions with US company management teams illustrate that labour shortages are still a daily headache, albeit one that is spurring innovation in automation and the use of remote working to recruit and work more efficiently. Overall, however, the US labour market is easing, suggesting further falls in US inflation on the way and the increasing likelihood of a soft landing in the US. This gives us confidence that any recession is likely to be milder than we feared a few months ago, and that US consumers remain in good shape.

[1] Macrobond, 19.09.23

SARASIN

IMPORTANT INFORMATION

This document is for residents of the US only and is not for onward distribution. If you are a retail investor, you should not act or rely on this document but should contact your professional advisor.

This communication is sent on a confidential basis, and you are welcome to discuss the materials with our staff. **This information may not be circulated to others without our permission.**

The information on which the document is based has been obtained from sources that we believe to be reliable, and in good faith, but we have not independently verifi ed such information and no representation or warranty, express or implied, is made as to their accuracy. All expressions of opinion are subject to change without notice.

US Persons are able to invest in units or shares of Sarasin & Partners LLP funds if they hold qualified investor status and enter into a fully discretionary investment management agreement with Sarasin Asset Management Limited. US persons are U.S. taxpayers, nationals, citizens or persons resident in the US or partnerships or corporations organized under the laws of the US or any state, territory or possession thereof.

This document has been prepared by Sarasin & Partners LLP ("S&P"), a limited liability partnership registered in England and Wales with registered number OC329859, authorised and regulated by the UK Financial Conduct Authority and approved by Sarasin Asset Management Limited ("SAM"), a limited liability company registered in England and Wales with company registration number 01497670, which is authorised and regulated by the UK Financial Conduct Authority and registered as an investment adviser with the US. The information in this document has not been approved or verified by the United States Securities and Exchange Commission (SEC) or by any state securities authority. Registration with the SEC does not imply a certain level of skill or training.

Please note that the prices of shares and the income from them can fall as well as rise and you may not get back the amount originally invested. This can be as a result of market movements and also of variations in the exchange rates between currencies. **Past performance is not a guide to future returns and may not be repeated.** Management fees and expenses are described in SAM's Form ADV, which is available upon request or at the SEC's public disclosure website, https://www.adviserinfo.sec.gov/Firm/115788.

For your protection, telephone calls may be recorded. SAM and/or any other member of the J. Safra Sarasin Holding Ltd group accepts no liability or responsibility whatsoever for any consequential loss of any kind arising out of the use of this document or any part of its contents. The use of this document should not be regarded as a substitute for the exercise by the recipient of his or her own judgment. SAM and/or any person connected to it may act upon or make use of the material referred to herein and/or any of the information upon which it is based, prior to publication of this document.

SARASIN ASSET MANAGEMENT
Juxon House
100 St. Paul's Churchyard
London EC4M 8BU
UK

T +44 (0)20 7038 7000
sarasinassetmanagement.com

00103_UK_6 October 2023 5:16 pm