# Evenlode Investment View

Wise Funds

FEBRUARY 2012 – THE COMMERCIAL COWS KEEP ON GIVING

**Global Economy Gathers Steam**

Markets have begun 2012 in a good mood – the UK market has now risen more than +20% since October. This is in large part due to signs that the global economy has not only stabilised but is beginning to gather steam. As I've said before, with interest rates stuck at next to nothing in most major economies, inflation is acting as 'the new interest rate', replacing interest rates as the most important moderator of the business cycle. Falling inflation over recent months has helped improve both consumer and corporate sentiment (globally, but particularly in the US). As a result economic leading indicators have been steadily rising since last autumn.

This rapid shift in sentiment serves – to me – as a reminder of how futile it is to get too caught up in Mr Market's 'mood of the moment' (from despair to elation in three months). We are very aware that market volatility will only serve us up opportunities if we remain objective and avoid trying to 'trend-follow'. Although the world faces an economic environment that looks significantly different to that which persisted for much of the last 30 years, the business cycle remains alive and well. Things can change quite quickly – a fact that should not be forgotten. Our aim is always to steadily move the portfolio toward the companies in our investable universe that offer the best quality-adjusted returns. Our approach is not deliberately 'contrarian', but it will normally involve shifting away from areas of the market that consensus is busy shifting toward.

**Cranking Up The Printing Presses**

With shades of early 2009, sentiment has also been helped by the impressive efforts of central bankers to print more money in recent months. As announced in December, the European Central Bank (ECB) has found a roundabout way (the 'Long Term Refinancing Operation') to pump liquidity into the European banking system. This is effectively a form of quantitative easing (QE) for the Eurozone, and its scale is eye-wateringly large – over the last three months, the ECB's balance sheet has grown at an annualised rate of +90%. I suspect that this is only a hint of the ECB's future excursions into the realm of monetary debasement.

Elsewhere, other central bankers have been busy too. Ben Bernanke has hinted at the possibly of further QE in the US, and the Federal Reserve have reiterated their intention to keep interest rates at their current rock bottom rates until at least the end of 2014. In the UK, a further £50bn of QE has been announced, whilst the Bank of Japan have also just announced an extension to its QE programme.

We are viewing all this activity with wide-eyes and no shortage of trepidation. Directionally we can't help but worry that higher inflation than we have today – possibly significantly higher – is a serious risk at some point over the next decade. The temptation is just too great to inflate away the debts that the world has found itself saddled with – inflation is the stealth tax that no politician needs to vote through.

**The 'Commercial Cows' Keep On Giving**

There is no perfect investment antidote to inflation, but we continue to think that the best protection from inflation (and one of the best from deflation too) is to own stakes in businesses that possess durable intangible assets to which customers habitually return. Warren Buffett reiterated this point nicely in his recent Fortune magazine article:

*"Whether the currency a century from now is based on gold, seashells, shark teeth, or a piece of paper (as today), people will be willing to exchange a couple of minutes of their daily labor for a Coca-Cola or some See's peanut brittle. In the future the U.S. population will move more goods, consume more food, and require more living space than it does now. People will forever exchange what they produce for what others produce. Our country's businesses will continue to efficiently deliver goods and services wanted by our citizens. Metaphorically, these commercial "cows" will live for centuries and give ever greater quantities of "milk" to boot. Their value will be determined not by the medium of exchange but rather by their capacity to deliver milk. Proceeds from the sale of the milk will compound for the owners of the cows, just as they did during the 20th century when the increased from 66 to 11,497 (and paid loads of dividends as well)."*

Buffett is mainly talking about the US here, but we think his point is even more valid when applied to the global population. If we're ever feeling nervous about goings on in the esoteric world of central bankers, it's nice to remember some of the franchises our 'commercial cows' possess. They include – among many others – India's most popular household cleaning brand (Reckitts), China's market leading condom brand (Reckitts), the biggest international spirit portfolios in Latin America, Africa and Asia (Diageo), and the world's market leading deodorant portfolio (Unilever). The compounding credentials of these franchises remain excellent. Reckitts pointed out at their recent results that there are c1 billion people in Europe and North America and c6 billion (and growing) in the rest of the world. However, Reckitts generates about 60% of its sales from the developed world. This leaves a long runway of growth potential in newer markets as real, inflation-adjusted consumption of the 'basic luxuries' that we take for granted heads higher. While we don't know what will happen to the world's currency regimes over the next decade, we do think that the 'commercial cows' we own will keep on giving. Moreover, as Buffett puts it, we think they will 'pay loads of dividends' as well. Taking a current pulse-check of this trend, dividend increases from Evenlode holdings announced over the last two weeks are as follows:

Unilever +9%
Diageo +7%
Reckitt Benckiser +9%
Smith & Nephew +10%
Glaxosmithkline +8%
Intercontinental Hotels Group +15%

**Quality and Value Remain High**

We continue to be impressed with the attractive opportunities available in the high-quality pond in which we fish. We shifted some money towards some of the more economically sensitive businesses in our investable universe at the end of last year (including Halma, Euromoney and Intercontinental Hotels Group). However, the recent outperformance of some of these stocks and the poor relative performance of some of the high quality blue chips in our universe has brought an end to this shift.For now we are very happy with the overall balance in the portfolio, but as always we remain open-minded to adjusting the portfolio as relative valuations evolve.

**Hugh Yarrow**
**February 2012**

*Please note, these views represent the personal opinions of Hugh Yarrow as at 18 February 2012 and do not constitute investment advice.*