



1. Economic and market environment

As I write this newsletter, the coronavirus outbreak has unfortunately become a major health crisis affecting most of the world's population, directly and indirectly. The measures taken by various governments across the world to counter the pandemic have put several billions of people under lockdown, have halted major sectors of the economy and will result in a significant economic hit. Short-term economic numbers will be extremely weak but as we have seen time and time again, the situation will eventually improve. As an investor myself, I understand that the current situation is unsettling and use a few mental guidelines to try to get through this crisis.

Panic and excessive, reactionary trading can destroy more value than the crisis itself. As a result of the high level of uncertainty, equity markets are currently extremely volatile. It is not uncommon for large companies to see their stocks fluctuate over 10 percent, up or down, several days in a row. Trying to predict these short-term moves is like trying to forecast the next lottery winning combination. A lot of people claim they can do it, but I haven't met anybody making a living out of it. Another value destroyer is panic selling and leaving the market to wait for a better economic environment. The stock market is a leading indicator and tends to precede real economic problems. During the last financial crisis in 2009, some of the best market days happened as unemployment rose. Selling during a difficult economic environment and buying when things appear better often leads to selling at the bottom and buying at the peak. In these volatile times, we think it is crucial to stick to one's long-term investment goals and not take any rash decisions. That said, we will continue to act if we believe that changes in the economic environment significantly increase the long-term risk or decrease the long-term return potential for a stock.

A lot of investors also ask if it is the right time to buy more. The overall stock market is certainly cheaper than at the beginning of the year, but the decision to buy or not depends on personal circumstances. Unfortunately, this health crisis is likely to have significant economic consequences, such as an increase in unemployment and bankruptcies, making the existence of some cash savings essential. It would be unfortunate for investors to increase allocation to the stock market and then sell in a panic a few weeks or months later as a result of personal financial needs. If one's personal financial situation is solid with an investment horizon of a minimum of three years, it is probably a good time to start slowly increasing equity-based investments.

The current virus outbreak is affecting three crucial spheres of our societies: public health, the real economy and the financial economy. Each sphere is highly interdependent and there can be unfortunate domino effects if problems emerging in one sphere are not controlled quickly. The quicker and more efficiently governments, companies and central banks address the problems arising in one sphere, the less damaging the long-term consequences will be. Several camps are already emerging. East Asian countries - principally South Korea, Japan, Singapore, China and Taiwan - were the first to control the health crisis, leaving them now more room to tackle financial and economic issues¹. In Europe, we are now in the most acute phase of the health crisis and governments have taken unprecedented measures

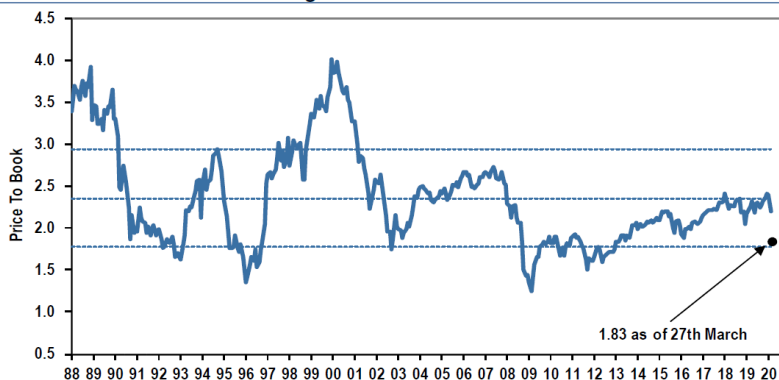
¹ For those interested to learn more about how Asia tackled the health crisis compared to what is happening in Europe <https://www.scmp.com/news/world/europe/article/3077824/why-europes-hospitals-among-best-world-are-struggling-coronavirus>

on the economic front (e.g. wage & loan guarantees and grants) and in financial markets (e.g. quantitative easing to compress bond spreads) to limit the contagion. The US government, after a few complacent weeks, is finally taking full grasp of the potential crisis and taking aggressive measures on every front – including taking interest rates back to 0%, massive quantitative easing, an USD2 trillion package to help workers and sustain the economy, and city lockdowns to reduce the virus spread. The measures taken to sustain the economy and financial markets, while necessary to avoid a significant economic depression, will have a long-term impact on the potential return of asset classes. The first major impact is the increase in leverage of already highly indebted national governments. The first rescue package will add the equivalent of 10% of GDP to US government debt, which already stands at more than 100% of GDP. It is therefore no wonder that the American president continues to push the federal reserve to lower interest rates to keep the interest bill in check. In Europe, leverage is also on the high side, except for Germany and other Northern European countries. As in the United States, the aggressive state rescue will require low interest rates for longer. All these measures indicate that we are unlikely to see a rise in interest rates for a long time.

The other major economic event of this crisis is the collapse in oil prices due to a combination of demand destruction and a supply glut from Saudi Arabia, Russia and shale producers in the US. This is a disaster for Middle Eastern Economies and Russia, which are heavily reliant on hydrocarbons, and not great for the US economy where the shale boom helped the economy to recover from the financial crisis in 2009. This is much more positive for Europe, which might be able to raise gas taxes somewhat to finance its green transition, and for Asia, which produces very little oil and gas and is reliant on imports. For economies like India, where oil prices have a significant impact on macro-economic balances and household budgets, the collapse in oil price will leave more room for central banks to cut interest rates and for households to boost consumption once the healthcare crisis is over.

How do all these events translate into investment decisions? We can safely say that aggressive trading, market timing and leaving the market altogether for a while will very likely destroy value. It appears that central banks and most governments will take very aggressive measures to avoid a financial crisis and a meltdown of the real economy. This will impact sovereign balance sheets and will likely result in low rates for longer which should support equity valuation. As we can see on the graph below, the market trades close to trough valuation levels.

Chart 19: Global Price-to-book trailing



Source: BofA Global Quantitative Strategy, MSCI, IBES

The other key variable driving the stock market is earnings, which will be down significantly for a few quarters but will likely recover in 2021. Approximately 60% of the weight of the MSCI All World Index is the US market, making the S&P500 an interesting gauge of what might happen. Goldman Sachs in a study on April 1st analysed what the impact of the lockdown could be on earnings and found that earnings of the S&P500 could go down 33% in 2020 but would likely recover most of the lost ground in 2021. We think Asian markets, namely Japan and China, could do a little better.

Exhibit 1: GS top-down EPS forecasts versus consensus bottom-up estimates

| | 2017 | 2018 | Goldman Sachs top-down | | | Consensus bottom-up | | |
|-----------------------------------------------|--------------|--------------|------------------------|--------------|--------------|---------------------|--------------|--------------|
| | | | 2019E | 2020E | 2021E | 2019E | 2020E | 2021E |
| S&P 500 ex-Financials, Utilities, Real Estate | | | | | | | | |
| Sales Per Share | \$1016 | \$1111 | \$1164 | \$980 | \$1180 | \$1164 | \$1187 | \$1264 |
| Year/Year growth | 7 % | 9 % | 5 % | (16)% | 20 % | 5 % | 2 % | 6 % |
| Profit Margin | 10.0% | 11.3% | 10.7% | 8.7% | 11.2% | 10.7% | 10.1% | 11.2% |
| Year/Year growth | 57 bp | 122 bp | (54)bp | (201)bp | 252 bp | (54)bp | (64)bp | 111 bp |
| S&P 500 adjusted EPS | \$133 | \$163 | \$165 | \$110 | \$170 | \$165 | \$159 | \$183 |
| Year/Year growth | 12 % | 23 % | 1 % | (33)% | 55 % | 1 % | (3)% | 15 % |

Source: FactSet, Goldman Sachs Global Investment Research

A more granular analysis of earnings gives a good break-down by sector and shows how a big chunk of earnings should not be affected too much by the virus lockdown. Big earnings contributors like IT (19% of earnings), healthcare (16% of earnings) and communication services (10% of earnings) should prove relatively resilient and rebound quickly in 2021. This scenario does assume that governments control the outbreak from this point and manage the financial and economic impacts relatively well. In the same analysis, Goldman Sachs estimates that a longer virus outbreak and a longer economic recovery would lead the S&P500 earnings per share to be 30% lower in 2021 than in 2019.

Exhibit 13: GS top-down vs. consensus bottom-up sector EPS estimates

| | 2018A | 2019A | GS Top-Down | | | | Cons. Bottom-Up | |
|------------------------------|--------------|--------------|--------------|--------------|--------------|-------------|-----------------|-------------|
| | | | Contribution | | EPS growth | | EPS growth | |
| | | | 2020E | 2021E | 2020E | 2021E | 2020E | 2021E |
| Utilities | \$5 | \$5 | \$5 | \$5 | 1 % | 6 % | 5 % | 4 % |
| Consumer Staples | 11 | 11 | 11 | 12 | 1 | 10 | 3 | 7 |
| Health Care | 25 | 27 | 26 | 30 | (1) | 14 | 4 | 11 |
| Comm Services | 16 | 17 | 14 | 19 | (17) | 34 | (3) | 16 |
| Information Technology | 32 | 32 | 24 | 35 | (26) | 49 | 4 | 16 |
| Real Estate | 4 | 4 | 3 | 4 | (30) | 30 | 10 | 6 |
| Financials | 29 | 30 | 17 | 29 | (45) | 70 | (4) | 7 |
| Materials | 5 | 4 | 2 | 4 | (51) | 95 | (1) | 20 |
| Industrials | 16 | 15 | 6 | 15 | (61) | 149 | (13) | 30 |
| Consumer Discretionary | 13 | 13 | 3 | 13 | (78) | 374 | (9) | 27 |
| S&P 500 ex-Energy | 154 | 158 | 111 | 166 | (30) | 50 | (1) | 14 |
| Energy | 9 | 6 | (1) | 4 | (108) | NM | (66) | 96 |
| S&P 500 EPS | \$163 | \$165 | \$110 | \$170 | (33)% | 55 % | (3)% | 15 % |

Source: FactSet, Goldman Sachs Global Investment Research

In conclusion, in this uncertain world, we think that global equity markets continue to represent a relatively good investment opportunity - being diversified, liquid and with good return potential, as valuation levels are close to an historic bottom. However, there are always tail risks, i.e. the epidemic could get out of control, unemployment could increase to unprecedented levels or there might be greater financial contagion. Therefore, more than ever, we think that having a good cash buffer is important. For investors with long term prospects looking to protect their purchasing power, the global stock market continues to be an attractive investment opportunity.

2. Our convictions

The virus outbreak has not spared our strategy with most companies affected directly or indirectly. It is important to remember though that the value of a stock is determined by the cashflows to shareholders over the lifetime of the business. As long as a crisis does not force a company to raise capital at a distressed valuation or materially affect the business model in the long term, then the intrinsic value of a company will not change materially even if the stock might be down a lot. By staying focused on buying leading companies in growing sectors at reasonable valuations, we think that we will eventually recover from this storm and generate good returns².

Looking at our investments' performance, most of our best performers were in China, as the country emerged first from the pandemic and a lot of our investments were only temporarily affected by the lockdown. Our investments in convertible bonds also mostly performed better than the market, as the bond floor provided some protection. The stocks which suffered the most were our investments in financials, as their business models are generally more affected by economic crises. Consumer lenders like **NORWEGIAN FINANS HOLDING** suffered from the expectation of higher delinquency rates. While true, every crisis is temporary and also affects competitors. A company like **NORWEGIAN FINANS HOLDING**, with its efficient direct marketing, large capital base and good risk control should go through the crisis more smoothly than its smaller competitors and is likely to grab market share in the long-term. A reasonable amount of consumer credit can also help some households to improve short term cashflows when facing a tough time. The stock trades on 3.6x trailing earnings and below book value, which we think is an over-reaction to the potential loan losses arising from this crisis.

Most of our investments in India, **UPL**, **L&T TECHNOLOGY**, **ADANI PORTS** and **INDIABULLS HOUSING FINANCE** also fell due to the expected general slowdown of the economy. We do not think that over the long term the virus will have an impact on the necessity to run better & more efficient agriculture and **UPL** should eventually recover. India will continue to need new, bigger and more efficient ports once the temporary slowdown tapers off, which can be provided by **ADANI PORTS** and Western companies will continue to need a well-educated and efficient engineering talent force, benefitting **L&T Technology**. These stocks now trade on mid-to-high single-digit price-earnings ratios with competitive business models and continue to address the needs of their customers. 2020 earnings will need to be downgraded but 2021, 2022 and subsequent years will most likely not, or at least not to the extent that the recent stock routs imply.

On the brighter side, our investments in China did reasonably well against this backdrop. **VIPSHOP HOLDING** continued its comeback and delivered excellent 4Q19 results and a positive guidance for 2020. The Company continued to reap the rewards of its restructuring efforts that started two years ago, with a partnership with Tencent and JD.com, and added a new partner, SF Express, last year to bring down its logistics costs. The partnership with Tencent, the largest social network in China, helped **VIPSHOP HOLDING** to regain momentum in customer acquisitions and the outsourcing of logistics had a significant positive impact on margins. Being the leading online discount retailer in China is also a good position to be in when all physical apparel retailers are closed. Crises tend to accelerate fundamental changes in societies and we think that this one will be no different. E-commerce has been taking share from traditional retailers over the last few years and the pandemic is only likely to make this transition faster. Despite good results and strong prospects, the stock continues to trade at a reasonable valuation of 9.6x forward earnings.

As of the 1st April, approximately 35% of our investment exposure is in Chinese companies, in food with **DALI FOOD**, in apparel e-commerce with **VIPSHOP HOLDING**, in furniture with **MAN WAH HOLDING**, in software with **CHINASOFT** and in food additives and ingredients with **FUFENG**. These businesses proved to be relatively resilient during the crisis and should bounce back now that China has re-opened its economy. Our exposure to India is around 10% and as explained above is mostly in large companies with solid and growing businesses. Given its high level of poverty and relative lack of hygiene, there is a risk that the virus affects India disproportionately. Nonetheless, knowing its weaknesses, the government was one of the first to block international travellers and imposed a lockdown before most developing countries. Outside Asia, our large investments are in American equipment rental companies **ASSTEAD** and **UNITED RENTALS**, service office providers **IWG (REGUS)**, pharma research and marketing outsourcing through **SYNEOS HEALTH**, convenience stores with **ALIMENTATION COUCHE TARD**, retail and healthcare logistics with

² No guarantee of results or performance

ZEBRA TECHNOLOGIES and pharmaceuticals with **HORIZON PHARMACEUTICALS**. The whole equipment rental industry tends to suffer when there is a major recession, as companies stop investing to conserve as much cash as possible, but there are a few advantages for large companies like **UNITED RENTALS** and **ASSTEAD**. First, the biggest cost for these companies is buying new equipment which can be quickly slowed down or stopped for a period. Second, their wide portfolio of equipment and geographic exposure makes it possible to soften the blow especially compared to smaller competitors. Construction projects have likely slowed down or stopped in some infection hotspots like New York but are continuing elsewhere. Finally, **AHSTEAD** and **UNITED RENTALS** have much better access to finance than smaller competitors, which should help in capturing share once the industry bounces back. Equipment rental also tends to recover much faster than deep cyclical as they benefit from government construction programs and are a flexible solution for industrial companies looking to quickly restart their operations.

IWG's stock suffered significantly from the pandemic, but the business might actually be a net beneficiary of this crisis in the long term. Firstly, this crisis will be a significant challenge for competitors like WeWork or smaller companies relying mostly on offices in expensive cities like London, New York, San Francisco and Shanghai. These companies with offices in the centres of the epidemic outbreak are likely to suffer the most given their levered business models. Secondly, this crisis will probably result in a higher uptick of flexible working schemes, partially from home and partially in offices. This could benefit **IWG** which offers the widest flexible office network in the world with outposts in big and small cities. As with every crisis, the stock recovery will take more time than the fall, but we think it will eventually be a rewarding investment for the patient investor.

Finally, we have some healthcare exposure through our investments in **HORIZON PHARMACEUTICALS** and **SYNEOS HEALTH**. **HORIZON PHARMACEUTICALS** has been doing very well compared to the rest of the market, as a successful developer and acquirer of drugs treating rare diseases. We found this investment through our screening of convertible bonds and were attracted by the successful track-record of management at finding niche products and expanding their usage. The Company continued its winning streak, generating excellent returns, especially compared to the market. **SYNEOS HEALTH's** stock has been affected by the recent market rout, despite being in a defensive sector, but we think that the Company's long-term prospects remain intact. The Company has two core businesses: clinical research outsourcing and contract marketing outsourcing for large and small pharmaceutical companies. By combining these two services, **SYNEOS HEALTH** is the only company in the world able to offer a complete solution for biopharmaceutical companies to complete the clinical research and commercialisation of new drugs, enabling clients to fully focus on fundamental drugs research. The business is likely to be somewhat disrupted by the pandemic for a few quarters but in the long term the pharma sector will continue to need platforms to make clinical research and drug marketing as efficient as possible.

These are testing times for all companies across the world, but people will need to continue to live, consume and eventually even travel. We believe that owning real assets, run by entrepreneurial management teams, will eventually pay off and remain as committed as ever to this investment approach.

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