Chawton Global Equity Income Fund

December 2023

CHAWTON
GLOBAL INVESTORS

Quarter Ended 31 December 2023

Overview

After a long period of stagnation fund performance really took off in the last quarter of 2023 resulting in a decent gain for the year. We acquired two new holdings both financials but with very different characteristics. Our stewardship activities included meeting two European companies held to better understand their Governance and incentivisation structures and we came away pleased.

Performance

The Fund, and equites generally, finished the year strongly resulting in the former rising 10.8% over the course of 2023. This improves the longer-term compound annual growth (CAGR) to 8.8% since inception over 4 years ago. A breakdown of performance is shown below for the fourth quarter 2023 and preceding periods. The Fund results are net of fees and charges and are compared to the benchmark index (MSCI World GBP) and the comparator group as represented by the Investment Association Global Equity Income sector.

Discrete Performance	2019	2020	2021	2022	2023	2023 Q4
WS CGEIF B Acc GBP	9.3%	14.2%	18.2%	-8.3%	10.8%	6.9%
MSCI World TR in GBP	8.6%	12.3%	22.9%	-7.8%	16.8%	6.7%
IA Global Equity Income	7.0%	3.2%	18.7%	-1.2%	9.2%	5.4%

	WS CGEIF B Acc GBP	MSCI World TR in GBP	IA Global Equity Income
Since Inception 19/05/2019 – 31/12/2023	49.7%	61.4%	41.6%
Compound Annual	8.8%	10.5%	7.6%

Source: FE fundinfo as at 31 December 2023. Total return in GBP. Past performance is not a reliable indicator of future results. The value of your investments and the income derived from it can go down as well as up and you may not get back the money you invested.

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The Fund rose by 6.9% in the fourth quarter of 2023 ahead of comparator global equity income funds. It finished the year ahead of these funds by 1.6%. Global equity markets, as represented by the MSCI Word (GBP) index rose 6.7% and are up 16.8% for the year propelled by the strong performance of US markets which constitute a high proportion of this index. The Fund is up 49.7% (B Class GBP accumulation shares) since inception (May 2019).

Activity

During the quarter we completed purchases of US payments company, Visa, and UK speciality insurance underwriter; Beazley. We sold Carlsberg Malaysia, a subsidiary of the Danish beer brewing group; Carlsberg.

Visa

Visa operates as an effective duopoly in global payments processing alongside Mastercard. The company has attractive financial characteristics; a factor of both its dominance and that limited capital is required to operate the business. Visa delivered a return on invested capital of 23% and a return on equity of 47% in 2023 and our research suggests this is sustainable over the long term.

The company has also exhibited strong growth over the last decade driven by the electronification of consumer payments to merchants (businesses) in turn driven by e-commerce. This trend continues. An additional growth driver over the next decade is the penetration of what is termed the business to business market where payments are made between businesses or within businesses. Uber making payments to its drivers is one example. The size of this addressable market has been assessed at $120 trillion and so there is a substantial pathway to further revenue growth.

There are some potential threats from new technologies and perhaps more significantly, regulators. However, new entrants would have to overcome a considerable barrier of convincing billions of consumers, millions of merchants and thousands of banks to switch away from the Visa network and trusted brand to a new sub-scale network and little known brand. The regulatory threat is not new and has been well managed by the duopoly.

We categorise the company as being in the growth part of its lifecycle but is already exhibiting powerful compounding characteristics given the low asset intensity. This also results in surplus capital which is returned through a dividend and significant share repurchases which are meaningfully reducing the share count. This is being carried out at what we believe is an attractive valuation.

Beazley

Beazley is a speciality insurance company providing insurance and reinsurance underwriting services for unusual and larger risks. The provision of property insurance for catastrophic risks such as hurricane damage is a good example.

The insurance industry requires capital allocation discipline centred around correctly pricing risk and being prepared to step back if the appropriate rate is not being offered. Risk pricing is currently being improved through greater use of data analytics for sophisticated risk assessment.

Insurance companies such as Beazley also benefit from a costless 'float' whereby they are able to invest premiums received in advance in monetary and productive assets. If both these factors are both properly managed, companies can achieve returns on capital (defined as equity) of 10-15% and as high as 20%

However, the insurance industry is characterised by most players favouring growth over pricing discipline. The industry therefore tends to move in long term capital cycles whereby short term capital is attracted in, eventually secures significant losses and then withdraws – I estimated each phase of the cycle i.e. the soft market and the hard market, are 5-10 years in duration each.

Two specific structural factors have impacted the market in the last ten years. Firstly, weather distortions caused by climate change and urban populations migrating to more exposed areas have led to increasingly severe property related catastrophic events. Secondly, most insurers are forced by regulation to hold most of their float in monetary assets with only a small portion in productive assets. With interest rates being low over the last ten years and near zero over the last five, it has been difficult to achieve any sort of return on the float.

However, recently, there has been a dramatic increase in premium prices which started in 2018 and accelerated in 2020. In 2022 and 2023, prices have achieved a level qualifying as a hard market i.e. participants should achieve an adequate return on risk. Berkshire Hathaway (held in the fund) which is conservative and very disciplined, meaningful increased its Property Cat. exposure from April 2023 proving confirmatory evidence. In addition, inflation has caused central banks to increase interest rates rapidly.

Beazley is UK quoted and conducts a significant proportion of its business through Lloyds of London. It runs a diverse underwriting book covering property, political, marine, and professional indemnity risks for both the primary and reinsurance markets. The company has exhibited good capital redeployment skills in the last decade through steadily reducing its exposure to property and allocating the capital to cyber and professional segments. In fact, as a first mover, Beazley has established a lead in cyber security insurance, a rapidly growing area.

As a result of these changing factors and prior discipline, Beazley is now redeploying capital to property. It is also securing a much better return on its float investment which is largely in short duration high quality bonds. The company is therefore likely to deliver good earnings growth, on average, over the next five years and associated good returns on equity. However, its valuation has remained low maybe caused by the lack of global investor interest in UK smaller companies. Accordingly, we have built a position in the company.

Carlsberg Malaysia

We have decided to sell Carlsberg Malaysia following on from the sale of its parent company discussed in a previous letter. The rationale can be summarised as a change in top management at the parent resulting in the risk of sub-optimal capital allocation in a very mature market.

Stewardship

In quarter 4, 2023, we participated in 3 Annual General Meetings on behalf of our clients, voting upon a total of 46 resolutions. To view our quarterly voting record, as well as a document summarizing voting activities, please click here. In November 2023 we engaged with two L'Oréal representatives via a virtual meeting which served as a platform for an in-depth discussion on capital allocation, acquisition criteria, growth in their digital segment and in emerging markets, how the Group manages the political risk associated with its operations in China and other critical sustainability factors.

Later on in the quarter we met Christian Buhl, CEO of Geberit, in London, where we discussed growth prospects in international markets and in DACH (Germany, Austria and Switzerland), their core region, as well as board dynamics. Our meetings served to reinforce our conviction in the strong leadership, capital allocation and sustainability strategies of both L'Óreal and Geberit, who are market leaders in their respective industries.

Conclusion

Pleasingly, strong performance in the final quarter of 2023 propelled the Fund to a good return over the whole year. It is performing ahead of other global funds with an income objective. We strengthened the fund through adding two high quality financial companies, Visa and Beazley, at attractive valuations. We continue to look for strong governance and stewardship capabilities at owned companies and found this to be the case through meeting with two European companies, L'Óreal and Geberit. We look forward to further progress in 2024 which has got off to a good start.

As a concentrated equity portfolio of typically less than 50 stocks the fund may involve higher volatility and therefore higher risk for those with shorter term investment time horizons (under 5 years). The value of an investment and the income from it can fall as well as rise as a result of market and currency movements and you may not get back the amount originally invested. You should therefore regard your investment as long term. Details of the risk factors are included in the fund's prospectus available at https://www.waystone.com/waystone-fund-services-uk-limited/ws-chawton-investment-funds/

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