



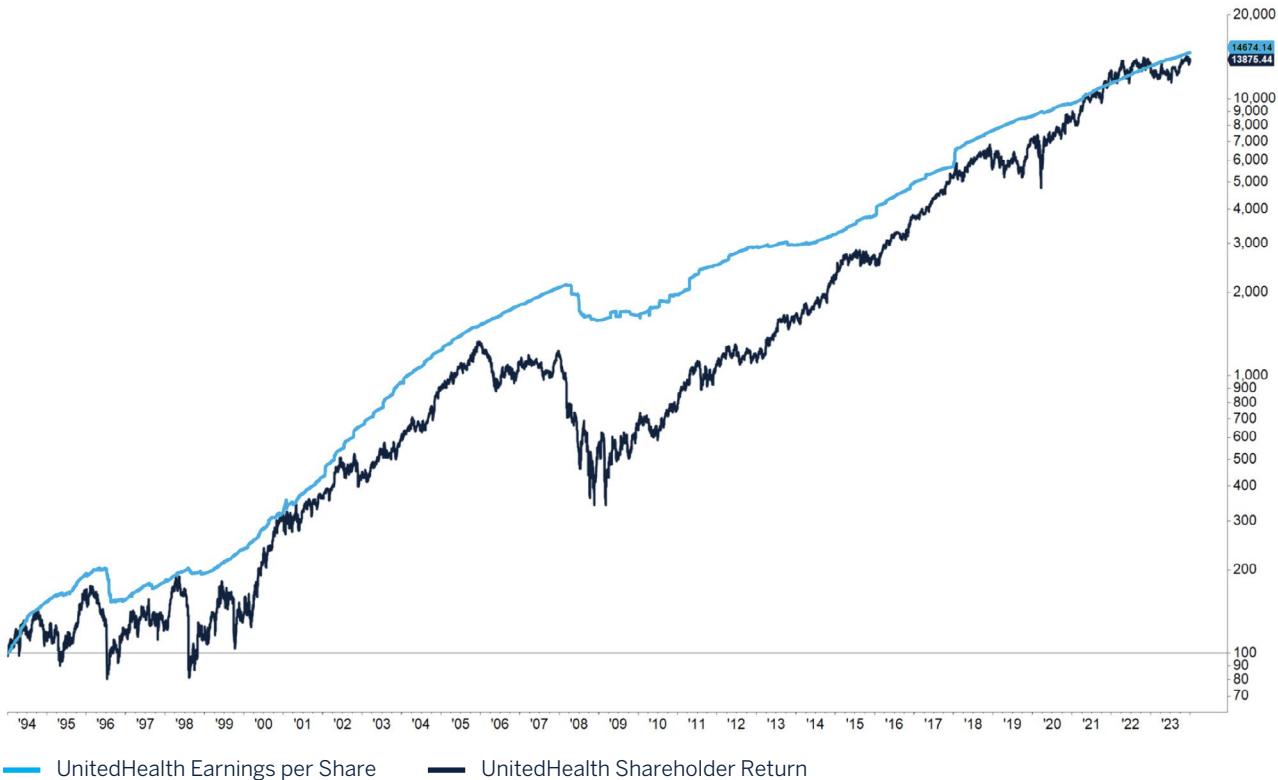
# Melville Douglas Quarterly Commentary Global Equity Fund

/ Q4 2023

## Follow the money

According to Napoleon, a good sketch is better than a long speech. The below chart encapsulates what we look for when selecting investments.

### SHARE PRICES ANCHOR TO PROFITS



Source: Melville Douglas, FactSet

The black line shows the total shareholder return (i.e. share price appreciation and dividends) and the blue line the earnings per share for a core holding in the fund, namely UnitedHealth. As one of the largest US health insurers, it benefits from ongoing growth in healthcare spending and the concomitant budgetary pressure to be more cost effective. We don't see these growth drivers meaningfully changing any time soon, and therefore we are happy to remain invested.

Investors are more inclined to pay a higher share price for a company that has increasing earnings power as it will be in a stronger position to pay shareholders higher dividends or buy back more shares. In the case of UnitedHealth, the company has grown earnings per share by a stunning 150 times over the past 30 years. This improvement in profitability has turned each \$1 shareholder investment in 1993 into \$140 today.

With hindsight, putting all your money in UnitedHealth shares in 1994 would have been extraordinarily lucrative. Would we expect a similar outcome today? A repeat of 140-times returns would be a stretch given we are starting from a much higher base, but we do expect the shares to handily beat the market index. However, no-one has certainty over the next 30 years. Politics and regulators could intervene for rational and irrational reasons. Our judgement is that neither a President Trump nor President Biden would meaningfully rock the boat in healthcare. But the last few years remind us that we live in uncertain times.

Fortunately, we don't need to put all our eggs in one basket. As the global investment universe is relatively large there are sufficient alternatives with similarly attractive earnings trajectories. A sample of the fund's holdings are shown below – all have compelling upward sloping long-term earnings histories and sustainable competitive edges to enable more of the same going forward. As they are exposed to different industry sectors, geographies, and secular growth trends they mitigate the risk of meeting an investment Waterloo.

## Proven earnings compounders

### AI & NEW WAYS OF WORKING



### CASHLESS SOCIETY & FINANCIAL REVOLUTION



### HEALTH INNOVATION & AGEING POPULATION



### ASPIRATIONAL MIDDLE CLASS CONSUMER



Source: Melville Douglas



## From our **Fund Manager's Desk**

We regularly explore the investment rationale of one of the companies we own in the Melville Douglas Global Equity Fund to articulate what we find compelling. This time round we have chosen Thermo Fisher Scientific, a powerhouse in driving a healthier world.

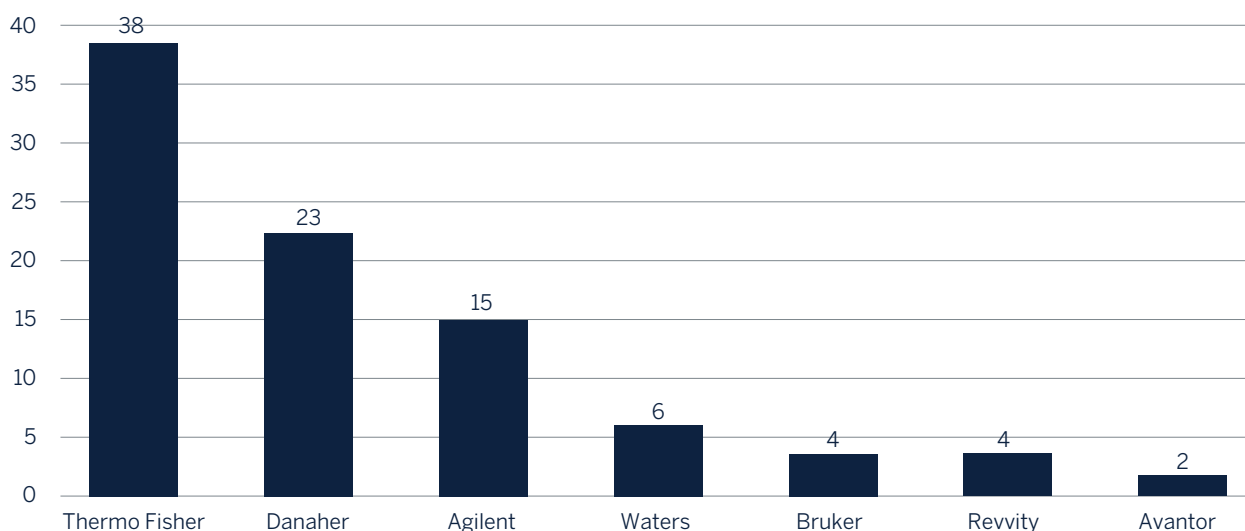
Professor Stephen Hawking once said, "Investing in science and technology is investing in the future". As one of the leading suppliers and service providers in the life sciences and tools industry, Thermo Fisher is a key enabler of such investments in the healthcare sector while also playing a role in the environmental and industrial spheres.

Over its rich 70-year history, Thermo Fisher's unparalleled array of instruments, consumables and services are mission critical for the pharmaceutical and industrial industries, academia, and diagnostic healthcare to address the world's most pressing challenges. These include combating infectious diseases, accelerating drug discovery and development, advancing personalised medicine,

ensuring food safety and quality, and protecting the environment. As an indispensable partner to scientists, Thermo Fisher invests deeply in research and development to bring cutting-edge technologies to its customers. As its customers succeed, so does it through higher sales, attractive profits, and new growth avenues.

## An innovation leader amongst its life sciences and tools peers

**CUMULATIVE INNOVATION AWARDS (2018 - 2022)**



Source: Company reports, Bernstein



## Broad exposure to the healthcare industry



## Thermo Fisher's businesses are divided across four categories:

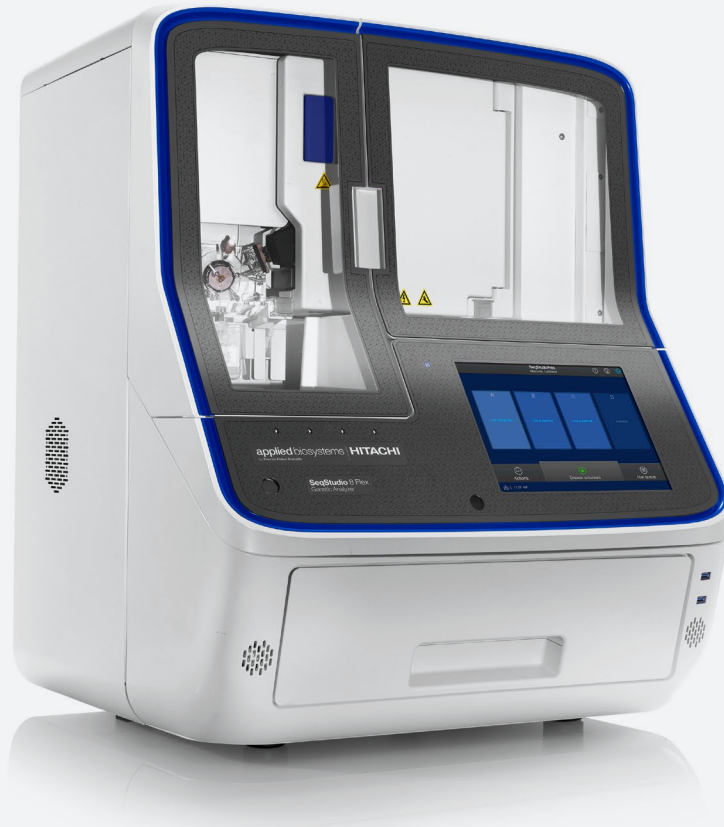
### 01. Life Sciences Solutions – empowering researchers

Thermo Fisher's Life Sciences Solutions portfolio provides scientists with tools used in drug and vaccine discovery and early disease diagnosis. This includes areas such as personalised medicine and cell and gene therapy, which are at early stages of development and harness the power of cells and genes to treat and cure diseases through targeted treatment.

Products include its genetic analysers, such as the SeqStudio Flex, which has the remarkable ability to read the building blocks of DNA. This allows scientists to understand how genes work and identify

mutations which can cause diseases. Its analysers are also able to measure DNA fragments and how many copies there are. This provides scientists with a deeper understanding of gene expression, which is the process by which genes are activated or silenced, ultimately influencing cell behaviour and function. Applying this to practice, researchers are developing drugs which can turn on genes that suppress tumors or turn off genes which cause inflammation. From autoimmune disorders and chronic pain to cancer and cardiovascular disease, the potential applications of gene-targeted drugs are bountiful.

## A CUTTING-EDGE THERMO FISHER GENETIC ANALYSER



Source: Thermo Fisher

### 02. Specialty Diagnostics - early detection and accurate diagnosis

Thermo Fisher's comprehensive Specialty Diagnostic products enable timely and accurate patient diagnosis which allows for informed healthcare provider decisions and enhanced patient outcomes. These products are used both in clinical settings, such as hospital laboratories and clinics, doctors' offices, as well as in food safety laboratories for the safety and quality testing of consumer products. In clinical settings, their blood test systems are the backbone for disease diagnosis and monitoring, while specialized instruments and consumables enable diverse applications like drug and hormone testing, first-trimester screening, pathogen detection and testing for organ transplants.

### 03. Lab products - scientific breakthroughs are sown in well-equipped laboratories

The breadth and depth of Thermo Fisher's lab products provides customers with choice and convenience, making it a one-stop shop for all lab requirements. Thermo Fisher offers a broad spectrum of lab equipment, ranging from microscopes to incubators and furnaces which are used in the discovery of groundbreaking science. The consumables, such as plastics and chemicals, used in conjunction with the equipment, creates an attractive razor blade business model, as their single use creates a recurring revenue stream. A differentiating factor to the business is service.

Thermo Fisher provides clinical research services, where it performs clinical research on potential drugs on behalf of biopharma companies for a fee. The compelling feature is that revenue is earned irrespective of whether the potential drugs become commercially successful. For drugs that are approved, the company also provides outsourcing development and manufacturing services. Facilitating a swift and efficient drug development pathway, this outsourcing strategy allows biopharma companies to maximize the financial benefits during the patent-protected period of a drug.

## 04. Analytical Instruments - tackling analytical complexity

Thermo Fisher's Analytical Instruments product suite enables the understanding of diseases and biology and supports the research and development of drugs in the biopharma industry.

An illustration of this is the electron microscope, which has transformed the field of drug discovery. This tool allows researchers to visualize drug structures and their interactions at the atomic level, providing valuable insights for unlocking potential treatments for diseases. Electron microscopes are also used in understanding the behaviour of complex biological targets such as viruses which have enabled the development of antiviral drugs. The ability to see the previously unseen and understanding diseases at the atomic level is paving the way for more effective and targeted therapies.

### ATOMIC LEVEL ANALYSIS – THERMO FISHER ELECTRON MICROSCOPE



Source: Thermo Fisher

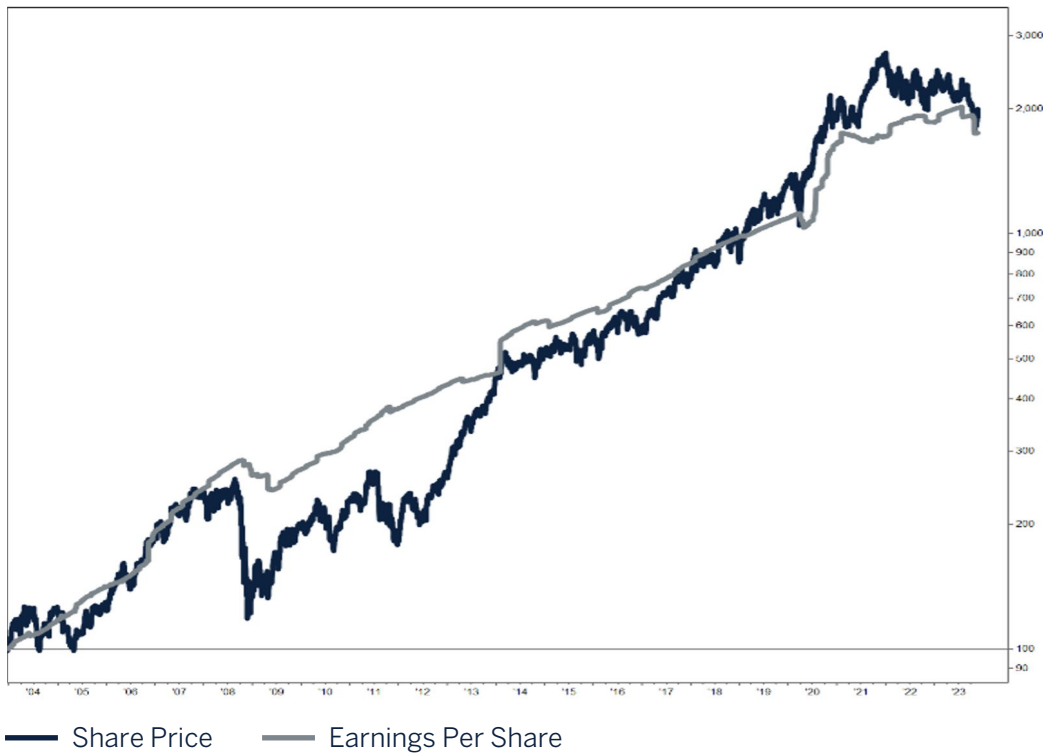
It's not just healthcare. The instrument portfolio also includes products which support the development of next-generation semiconductors and enable the clean energy transition by supporting the development of breakthrough battery technology. Thermo Fisher's tools solve complex quality control challenges by enabling the study and modification of the microscopic world of semiconductors while also speeding up time to market for manufacturers.



## A pillar of financial strength, investment potential and a force for good

Thermo Fisher's financial performance is a testament to a corporate culture of sound commercial strategies combined with an unwavering commitment to scientific advancement. The company has steadily grown its revenue over the past decade by +14% per annum, and earnings have exhibited robust +17% annualized growth. As shown in the 20-year chart, this has been the underlying driver of its commendable share price performance.

### THERMO FISHER SHARE PRICE - POWERED BY COMPOUND EARNINGS GROWTH



Source: FactSet

Over the pandemic, Thermo Fisher benefited from the essential materials and services provided to biopharma companies for the manufacturing of COVID-19 vaccines as well as through the sale of COVID-19 testing kits. This short-term boost has since unwound and temporarily stalled earnings growth and the share price. We see this as a contrarian opportunity for a long-term investor to gain exposure to a long runway of innovation driven growth.

Thermo Fisher is the picks-and-shovels supplier in ongoing scientific and technological progress. As such the shares tap into ongoing human ingenuity.



## Back in the Saddle

Global equities were back in the saddle in November and December after a bumpy ride over the prior three months. Softer than expected inflation data from the US, Europe and the UK spurred a powerful rally based on the view monetary tightening had peaked. Whether Federal Reserve Governor Powell can pull off a Captain Sully remains a topic of debate. More cautious investors would note the impact on the economy from sharply higher rates have yet to fully filter through. Markets are assuming the rose-tinted view for now.

With investors more confident about a soft landing, performance broadened out beyond the “magnificent seven” monopolistic US Tech stocks that had dominated returns earlier in the year. All the major industry sectors exhibited gains in the fourth quarter.

Human misbehaviour has been a constant in financial markets through the ages. The pattern stretches back to the likes of the South Sea bubble, the great railway mania, the Australian land boom, the British bicycle mania, the Wall Street crash, Japan in the 1990s, the Dot-Com bubble to the “no boom and bust” subprime bubble. History uncannily repeats itself again and again.

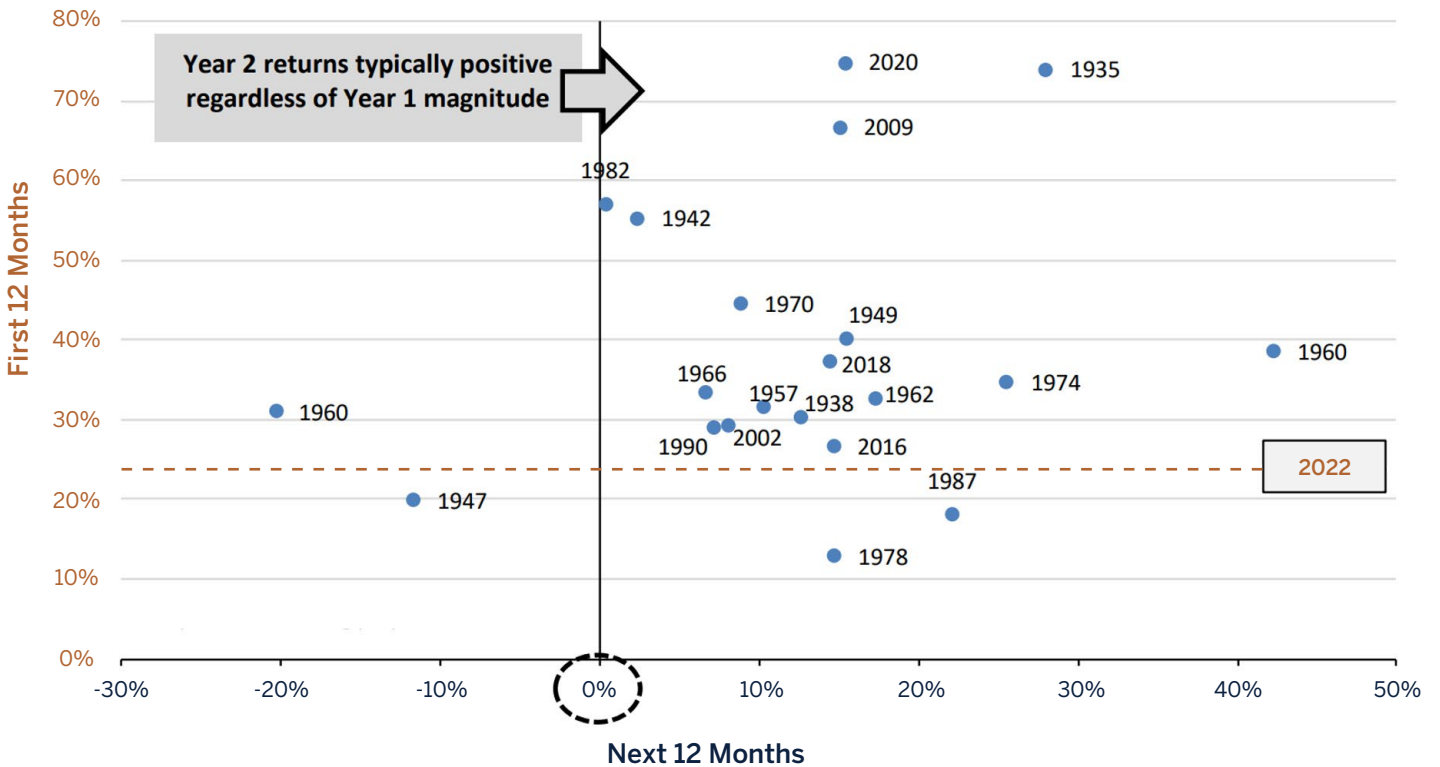
What lessons can we draw today?

One is that there is some truth to the adage that markets take the lift on the way down and the stairs on the way up. The most recent major market nadir was a little over a year ago, i.e. October 2022. Since then, the MSCI All Country World is up over +30%. Despite the temptation for investors to “take profits”, big rallies tend to beget further gains. A recent study by Oppenheimer & Co (see the below chart) found that the second year following a rally from a major low has been positive in 19 out of 22 cycles (the exceptions were 1932, 1947 and 1960).

**Momentum is a powerful thing – big bounces after a major low are more than a one-year wonder.**



## MAJOR CYCLE LOWS: 12M FORWARD RETURNS FOLLOWING INITIAL 12M RETURN



1932 isn't plotted for scaling purposes. Following a 138% gain in the first 12 months off its low, the S&P was down 1% in the next 12 months.

Source: Oppenheimer & Co

Another historical pattern is that equity markets tend to do well during a US presidential election year, particularly if the incumbent is running. Clearly, it is in the incumbent's interest to keep voters happy by ensuring they are in gainful employment.

In short, the odds are in your favour in 2024.

Beyond the vagaries of market timing, we remain long-term investors of some of the world's best businesses at reasonable valuations. These proven winners have been selected for their metronomic ability to create shareholder value based on a sustained competitive edge combined with a compelling growth runway.

We are reminded of Charlie Munger, who was Warren Buffett's business partner and who sadly passed away in November. He said, **"the big money is not in the buying or selling, but in the waiting"**.

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