



INVESTMENT UPDATE

10 March 2020

We would like to keep you up to date with our thinking in this period of extreme volatility and give you a quick update on our funds at Quaero Capital. In the fog of war, it is extremely hazardous to make any prediction and invariably, these tend to be highly contextual or misguided in a shock such as the one we have experienced this quarter.

We can however make a number of observations that we hope will be useful to our clients.

The world is in the middle of an important exogenous shock and the impact will be significant

The first set of comments focuses on what we currently know for certain: the world is in the middle of an exogenous shock and the impact will be significant. It is difficult to predict the depth and most importantly the duration of the slowdown in economic activity, but it is now obvious that the first quarter of this year will show close to zero or indeed, negative growth. From here, a lot will depend on the macro-economic policies put in place and the ability of the various governments to give a decisive and coordinated response to the current crisis. It may be a good opportunity to restore multi-lateral cooperation, but as of today, too few efforts to coordinate policies have emerged. Much ink will be spent debating whether the recovery will be V-shaped or U-shaped but suffice to say that today we still have too little information to make any meaningful prediction. As always, extreme forecasts in both directions will be proven wrong, but finding the balance will occupy financial markets in the coming weeks and we need to prepare for more volatility.

We still see an increase in the number of new infections in the Western world

The second interesting observation is that we still see an increase in the number of new infections in the Western world. We believe that this is especially true in the United States, where policy responses have so far been woefully inadequate. Given the recent experience in Europe, it is safe to say that the US has not yet woken up to the size of the problem, both from a purely public health perspective, but more importantly also from the social impact of taking measures similar to the ones that have been taken in Europe. This is likely to create more market turmoil and we are bracing for more challenging markets, even though valuations now clearly favour risky assets and anyone taking a long-term view from here is likely to be nicely rewarded.

Our entire business model is to try insulating ourselves from exactly this kind of environment

In this context, it is important to remind our clients that our entire business model has been to try to insulate ourselves from exactly this kind of environment. We have done this in several ways: first, our investment policies to “invest away from the crowds” mean that our portfolio of strategies is well diversified: all our funds are typically very niche and away from the massive ETF flows that have dominated the financial markets in the past 12 years. This has been a sometimes-arduous positioning considering the post-2008 passive mania, but it is serving us well in the current stampede.

European Small Cap Equities

In a similar vein, through our investment philosophy, we have naturally avoided sectors most exposed to the current economic woes. We have no investment in oil or mining, we are out of banks and airlines or most activities exposed to a potential credit shock, such as shale oil and exploration. In the small caps’ strategies, Philip and Mark have consistently shied away from making top down predictions. However, they have equally constantly repeated their mantra of

investing in quality companies with very strong balance sheets that will offer protection in exactly this type of environment. The portfolio valuation has been stretched to levels only seen in times of deep crisis and we do not see much downside from here, notwithstanding very short-term volatility.

Infrastructure Private and Listed Equities

Equally, our developments in Infrastructure, both non-quoted and through the UCITS strategies, validate our message of trying to invest in sectors largely immune to the vagaries of economic cycles. Our large exposure to renewable energies – and our dedication to investing in quality companies that are profitable – should not be impacted by the panic. As advertised during our many investors' presentations, companies' cash flow should remain largely stable. In fact, in both the Infrastructure Securities and the Accessible Clean Energy funds, our focus on growing companies that will benefit from the secular trend of government investment in both the energy transition and the renewal of our infrastructures will bear fruit.

Japan and Asian ex-Japan Listed Equities

Finally, our Asian strategies will benefit from both the fact that Asian countries came into this crisis earlier than the rest of the world (and hence have been less affected by the very recent market rout) and the considerable fall in the oil price. Even though Japan has been one of the most disappointing market in February and this week again, Rupert and his team continue to see encouraging signs of change in the corporate culture in Japan and a growing focus on shareholders' value. This will lead to better profitability for the corporate sector that is still very cheap by international comparison.

Looking forward

We need to stress yet again that we strongly believe that investing is a long-term game. In the highly distorted world of Quantitative Easing, it has been easy to forget. However, as painful as it may be, this crisis will be an opportunity to stop the exclusive reliance on monetary policy to support the economy and restart on a much sounder base. Just 3 weeks ago, most commentators felt that we had gone too high too fast and for too long. We may be just entering a very different world where finally fundamentals will count and patience will be rewarded.

Jean Keller
QUAERO CAPITAL
Chief Executive Officer

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