# Global Leaders Portfolio

**Portfolio Manager Commentary**
As of 6/30/2021

## Q2 2021 Overview

For the second quarter of 2021, the **Global Leaders Portfolio (GLP)** gained 13.08% (12.99% net) compared to its benchmark, the MSCI All Country World Index, which was up 7.39%. Year-to-date, GLP is up 13.91% (13.71% net) versus our benchmark, which has gained 12.30%. Our long-term performance results can be found in the table below.

The end of the second quarter also marks the seven-year anniversary of the Global Leaders Portfolio. We are pleased to report that since inception, July 1, 2014, GLP has produced a cumulative net total return of 137.36% compared to its benchmark, which returned 91.76%. Since inception, GLP has generated a net 13.14% annualized return compared to our benchmark, which has tallied a 9.75% annual return.

We remind our investment partners, the most important return is that which is achieved over the long term. As we have written in the past, noise is what you hear in the short run. The true signal—a more proper indicator for investors—is what you receive over the long run.

In the fall of 2020, we were among those who suggested the introduction of vaccines might not only protect individuals from contracting COVID-19, but could also work to help reopen our economy that had been shut down as a result of the global pandemic. We were optimistic that after enough vaccines were administered, economic growth would return most likely by the spring of 2021 accompanied by a significant recovery in the earnings of companies that had been shackled by a brutal recession.

The economic impact of COVID-19 in 2020 caused U.S. real GDP growth to decline 2.4% year-over-year—the first negative yearly reading in over 10 years. However, with the introduction of vaccines beginning in November of last year, the U.S. economy began to slowly reopen. In the first quarter of 2021, U.S. real GDP advanced 0.4%—a small economic advance but definitely in the right direction. With several vaccines being administered and more doors of the U.S. economy starting to reopen, we believed the recovery would soon move to full speed ahead.

Thus far the economy and the stock market have rebounded as we expected. In the second quarter of 2021, U.S. real GDP growth is expected to register 13.0% year-over-year. Remember in the spring of last year, with COVID-19 infections on the rise, our economy was shutting down. We believe the economic comparisons in the upcoming third and fourth quarters should also be strong in comparison to the lockdown period last year.

### Objective

Focused portfolio of leading global companies positioned to benefit from the unprecedented growth in worldwide consumer demand

### Portfolio Management Team

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*Chief Investment Officer*
*Senior Portfolio Manager*

Lauren E. Loughlin
*Associate Portfolio Manager*

### About EquityCompass

EquityCompass is a Baltimore-based SEC registered investment adviser offering a broad range of portfolio strategies and custom plans for individuals, financial intermediaries, and institutional clients in the U.S. Formally organized in 2008, EquityCompass provides portfolio strategies with respect to total assets over $4.6 billion as of June 30, 2021.*

The EquityCompass team of professionals represents deep industry experience in security analysis, capital markets, and portfolio management. We are committed to a consistent investment process that relies on enduring principles, sound empirical reasoning, and the recognition of a dynamic investment environment with a global reach.

| | Total Returns | | | Annualized Returns | | | | Calendar-Year Returns | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 3-Mos | 6-Mos | YTD | 1-yr | 3-yr | 5-yr | Inception | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| Gross % | 13.08 | 13.91 | 13.91 | 47.57 | 21.31 | 19.61 | 13.63 | -2.24 | 4.23 | 29.50 | -9.64 | 35.28 | 29.98 |
| Net % | 12.99 | 13.71 | 13.71 | 47.06 | 20.90 | 19.13 | 13.14 | -2.72 | 3.71 | 28.87 | -10.02 | 34.82 | 29.54 |
| Benchmark % | 7.39 | 12.30 | 12.30 | 39.26 | 14.57 | 14.61 | 9.75 | -2.36 | 7.86 | 23.97 | -9.41 | 26.60 | 16.25 |

As of 6/30/2021; Inception – July 2014; Benchmark = MSCI All Country World Index
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In our first quarter commentary, we noted value stocks, defined by the Russell 1000 Value Index, were handily beating growth stocks, defined by the Russell 1000 Growth Index. This was not surprising to us. Value stocks, which are highly dependent on an expanding economy, had suffered significant relative underperformance compared to growth stocks throughout much of 2020. But with the economy reopening, it was likely value stock earnings and price performance would improve. Indeed, when we compare the price performance of value stocks relative to growth stocks since September 30, 2020 (just prior to the vaccine announcements) through March 31, 2021, the Russell 1000 Value Index was up 29.34% versus the Russell 1000 Growth Index up 12.44%, including dividends. Indeed, the relative outperformance of value stocks compared to growth was the highest in 20 years.

However, in the second quarter of 2021 growth stock outperformance resurfaced. Between March 31 and June 30, the Russell 1000 Growth Index gained 11.93% compared to the Russell 1000 Value Index, which was up 5.21%, including dividends. This also is not surprising to us. Yes, the earnings growth rate of value stocks coming out of a deep recession in 2020 has significantly outpaced the earnings growth rate of growth stocks here in 2021. However, going forward the earnings growth rate differential between growth and value stocks, in our opinion, should begin to normalize. In other words, we believe it is likely the earnings growth rate for growth stocks will outperform value in 2022. In that the stock market looks forward, not backwards, and seeks to discount information out six months in advance, we would not be shocked to see the relative performance of growth stocks improve from here.

We share this information with you not because we import these findings into our portfolio management decisions, but as reference points to explain what has been occurring in the market. As we discussed in our first quarter commentary, the market's rotational shift between growth and value is nothing new. The stock market's push-and-pull opinions on earnings growth rates and prices among the growth and value camp are continuous. There are some portfolio managers who speculate on the rise and fall of these two groups, but that is not our approach. We are not stock traders—we are business owners, and what matters most to us are the sustainable economic returns of our companies and the prices paid for ownership.

## Portfolio Outlook

As business-driven investors, we remain singularly focused on the economics of the companies we own—specifically the cash generated by our businesses and the percentage return of that cash relative to the capital invested. We know companies that generate a cash return above the cost of capital—both equity and debt—increase the intrinsic value of the business, while those that do not destroy value over time.

We have noted on several occasions the significant difference between what is considered a good business and a great business. A good business earns cash returns above the cost of capital, while a great business can invest a large amount of cash at very high rates of return for an extended period of time. In our opinion, what makes a company great is one that can generate high returns on capital not for five years, but for 10 years or more. Our investment objective is to own great companies. In doing so, we believe we are in a position to compound, over time, above-average growth of intrinsic value which can lead to above-average performance gains.

Generating high returns on capital speaks to the attractiveness of a company's business model. Generating high returns on capital for an extended period of time speaks to a company's Competitive Advantage Period (CAP)[1], which is directly linked to the Total Addressable Market (TAM)—the amount of revenue a company could generate if it captured 100% share of the total market.

The wealthiest and most attractive total addressable market is the largest market—the global market. By 2025, the global consumer class is expected to almost double in size to 4.2 billion with annual consumption expected to rise to $64 trillion. Developing countries are expected to account for $30 trillion of world consumption (approximately three times current U.S. household consumption), up from $12 trillion in 2010.[2]

In our view, the global prize for middle class consumption resides in Africa and Asia. Many mistakenly believe Asia is China, when in fact it is a much larger marketplace. The Asian market is defined as West Asia (Middle East), South Asia (India, Pakistan), East Asia (China), and the 10 countries in Southeast Asia. The Association of Southeast Asian Nations (ASEAN) has a combined population of 650 million and a GDP greater than India.

(1) Competitive Advantage Period (CAP) is defined as the length of time a company can generate returns on invested capital (ROIC) in excess of the cost at which it can access capital (either debt or equity).

(2) *Winning the $30 Trillion Decathlon: Going For Gold In Emerging Markets*, McKinsey & Company, August 2012.

Although population growth is slowing in the U.S. and Europe and declining in Japan, it is accelerating globally. It is estimated that by the year 2100 the world's population will grow from 7.8 billion to approximately 11 billion with most of the world's growth of middle class consumers occurring in South Asia and Africa. Indeed, Africa's population of 1.2 billion is expected to double in the next 30 years. [3]

It was McKinsey & Company who called the defining megatrend of our age—the rise of the global middle class consumer—"the biggest growth opportunity in the history of capitalism."[4] The question is how to best take advantage of this unparalleled historic economic opportunity.

We believe there are two distinct strategies: (1) buy an emerging market company domiciled in an emerging market or country, or (2) buy a multinational company domiciled in a developed economy that sells products and services into emerging markets around the world.

For the Global Leaders Portfolio, we believe the better risk/reward approach for investors is to own blue-chip multinational companies in the developed world rather than take on too much risk by owning emerging market companies directly.

*Why?* Multinational companies domiciled in the developed world generally have better accounting transparency, robust corporate governance practices, and lower transaction costs while still generating above-average growth that is levered to emerging market economies.

We believe the Global Leaders Portfolio's concentrated, low turnover approach can be beneficial for building wealth and outperforming one's benchmark. Furthermore, with the average annual portfolio turnover ratio of U.S. mutual funds at over 100%, GLP's very low turnover ratio of 13% per year seeks to provide additional value through the ability to compound unrealized capital gains.

Although the Global Leaders Portfolio is owned in many tax-advantaged accounts, where paying short-term and long-term capital gains may be of no consequence, there are a great number of investors who own the portfolio in taxable accounts. All taxable accounts, if they sell GLP at a profit, must settle up with the IRS. But the longer you own an unrealized gain, the longer you can compound this tax-deferred gain before it will eventually be paid. The math is simple. Compounding a large number, even if it includes a temporary tax deferral from the IRS, makes future returns higher.

Since inception in July 2014, the Global Leaders Portfolio has endured significant headwinds: the corporate profit recession in 2016, which negatively impacted both U.S. and non-U.S. multinational companies; the constant volatility of the U.S. dollar index combined with antagonistic trade wars and tariffs; and the biggest challenge thus far, the COVID-19 pandemic that paralyzed global economies, causing a massive bear market and the deepest recession since The Great Depression.

Although no one can be certain what the next seven years will bring, we remain confident in our process of focusing on great global companies that seek to generate above-average economic returns, owned and managed in a concentrated, low-turnover portfolio that we believe will continue to generate favorable investment returns for investors.

The Global Leaders Portfolio mantra has been, and will continue to be, *it's never a bad time to buy a great company at a good price*.

(3) Rachman, Gideon, "Lousy Demographics Will Not Stop China's Rise," Financial Times, May 3, 2021.

(4) *Winning the $30 Trillion Decathlon*, McKinsey & Company.

**DISCLOSURES**

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*Total assets combines both Assets Under Management and Assets Under Advisement as of June 30, 2021. Assets Under Management represents the aggregate fair value of all discretionary and non-discretionary assets, including fee paying and non-fee paying portfolios. Assets Under Advisement represent advisory-only assets where the firm provides a model portfolio and does not have trading authority over the assets.

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MSCI All Country World Index captures large and mid cap representation across 23 Developed Markets and 21 Emerging Markets countries. The Russell 1000 Value Index measures the performance of those Russell 1000 index companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000 Growth Index measures the performance of those Russell 1000 index companies with higher price-to-book ratios and higher forecasted growth values. The index returns are presented on a total return basis, which assume reinvestment of all cash distributions (such as dividends). With 2,434 constituents, the index covers approximately 85% of the global investable equity opportunity set. The volatility of the indices identified in this report may be materially different from the volatility of the model portfolios presented by EquityCompass. Indices are unmanaged, do not reflect fees and expenses, and are not available for direct investment.

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