Summary BrightTalk Conference
FFG Global Flexible Sustainable

Strategy update

BLI - Banque de Luxembourg Investments S.A.
Funds For Goods
Octobre 29, 2020.

FFG Global Flexible Sustainable is an impact fund launched on 28 December 2017 whose investment policy is inspired by the BL-Global Flexible Fund managed by BLI for many years.

Funds for Good (FFG)

FFG, the Fund's initiator, **devotes 50% of its profits (with a minimum of 10% of its turnover) to social projects aimed at combating job insecurity by allocating honorary loans** (no interest, no guarantee) **to economically vulnerable people with a sustainable business project**. A network of volunteers provides support for the beneficiaries in their entrepreneurial project.
➔ Investing in the FFG Global Flexible Sustainable Fund generates a tangible impact.

ESG Policy

The Fund recently obtained the Belgian ESG label "Towards Sustainability" demonstrating the robustness of its ESG approach: exclusion ("do not harm"), improvement of the fund's profile in terms of carbon footprint and social quality, best-in-class strategy based on the MSCI ESG rating.

Macroeconomic environment

The significant rebound of **growth** observed in the third quarter is mainly due to the support measures implemented by the authorities; it is not organic growth. In addition, **structural trends, some of which have been amplified by the current crisis, are acting as brakes on the emergence of solid organic growth**: high debt (public and private), a dynsfunctioal eurozone, geopolitical tensions, a slowdown in world trade, lack of "creative destruction", a growth model based on private consumption, and growing social inequalities.

Since 2008, the speed of money circulation has only decreased avoiding an increase in **inflation**. **In the short term, inflation is expected to remain moderate, but in the medium to long term, the situation could change**. If the real economy takes over (digitalisation, robotisation, undynamic consumption), the disinflationary environment will continue, if it is political economy that prevails (increase in public spending financed by monetary growth), we could see a rise in inflation.

Overview of the financial markets

The current crisis has confirmed or even reinforced an environment of very low interest rates for a long time to come. Bonds are a risky (high duration) and unattractive (low yield) asset class.
For the **equity markets**, the rebound initiated at the end of March was surprisingly strong and rapid. **Several prevailing trends have also been amplified by this unprecedented situation:** outpferformance of the US market and technology stocks, a low interest rates environment explains the historical high levels of valuation and the current success of growth stocks.
All the conditions are in place for a **structural rise in the price of gold**, **which should benefit gold companies**. However, we must remain aware of the inherent **volatility** of this type of investment.

At present, it is **essential to rethink our conception of risk**, the main risk today no longer lies in volatility but in the **possibility of permanently losing part of one's capital**.

→ Real assets such as shares should be preferred to monetary assets
→ In the stock markets, one must stand out from the indices and be selective.
→ Gold, if its volatility is understood, retains a prominent place in a diversified portfolio as the main insurance against irresponsible monetary and fiscal policies.

Portfolio positioning

In March, the Fund Manager took advantage of the equity market correction to increase investments while hedging part of the equity risk given the uncertainties surrounding the sustainability of the economic recovery. With gold in a favourable structural environment, the weighting is now at its maximum.
At end of September 2020 :

- Equities
  - Gross exposure: 63%
  - Net exposure: 49.7%
- Bonds: 4.6%
- Gold: 14.4%
- Cash: 18%

FFG Global Flexible Sustainable is an impact fund launched on 28 December 2017 whose investment policy is inspired by the BL-Global Flexible Fund managed by BLI for many years.

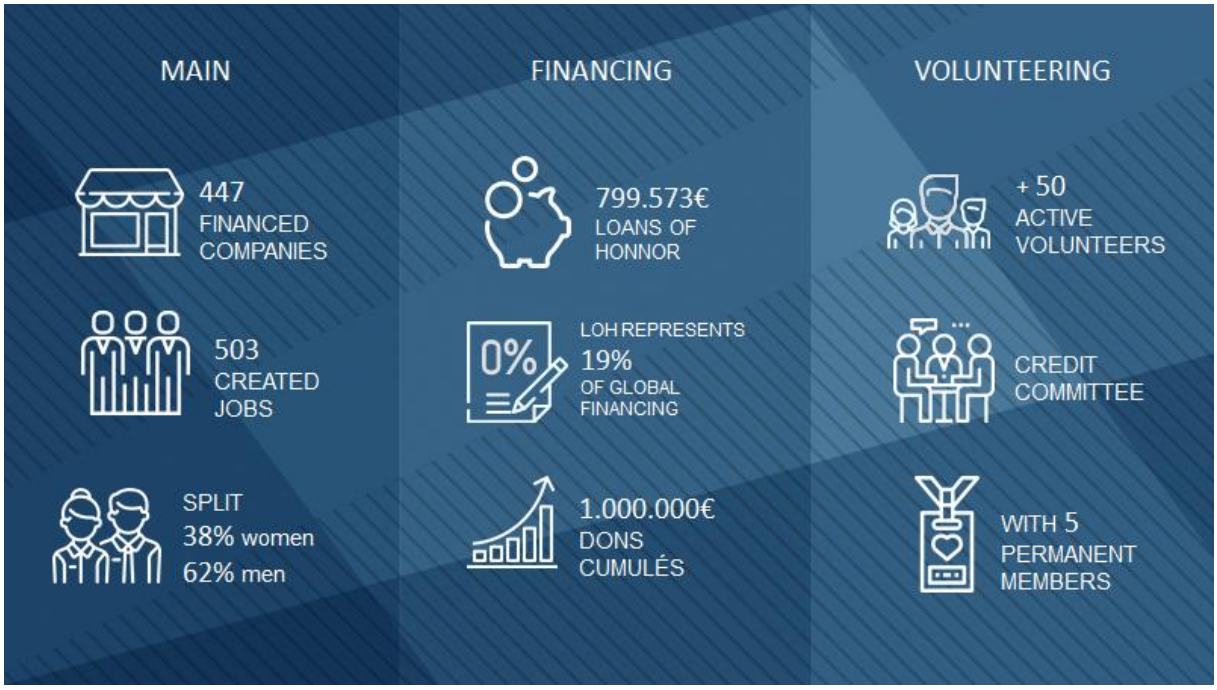
Introduction - Funds for Goods (FFG)

Funds for Goods is the initiator of the FFG Global Flexible Sustainable Fund while BLI is responsible for the portfolio management.
Funds For Goods devotes 50% of its profits (with a minimum of 10% of its turnover) to social projects, without in any way affecting the return on investment.
This financing is carried out through the "Funds For Goods Philanthropy" Foundation, which devotes all of its financial resources to the **fight against poverty by allocating honorary loans** (no interest, no guarantee) **to economically weakened people** (unemployed, part-time jobs, low pay) **with a sustainable entrepreneurial project**. **Support for the beneficiaries** in their entrepreneurial project is also carried out via a **network of volunteers** (composed of FFG employees, partners, investors, etc.).

Recently, FFG has also been supporting social entrepreneurs who have a development project to meet social and/or environmental needs.

➔ **Investing in the FFG Global Flexible Sustainable Fund generates a tangible impact.**

Currently FFG supports projects in Belgium, France and Luxembourg. Since the beginning of the project, FFG has made the following progress:



Gender parity would have been desirable but unfortunately cannot yet be achieved since women submit only 20% of the files presented, but these files are generally more solid.

The Covid-19 crisis has had a severe impact on the project initiators supported by FFG since they are generally in already fragile financial situations. Thus, FFG has set up various initiatives to support these people and others in this crisis that is generating poverty (postponement of payment deadlines for honour loans, increase in the budget available for granting loans, support from large companies, specific projects to enable the continuation - even limited - of the activity, etc.).

Integrating an ESG policy into the investment process

The Fund has recently been awarded the Belgian ESG label "Towards Sustainability" demonstrating the strength of the ESG approach implemented.
This approach is based on several pillars:

1) **Exclusion policy** known as "do not harm" based on certain activities (arms, tobacco, coal in particular) but also exclusion based on non-compliance with major international conventions.
2) **Carbon footprint** of the portfolio must be 20% below the market average (MSCI AC World).
3) **Social quality** of the portfolio must be 10 to 20% higher than the market average (MSCI AC World).
4) **A best-in-class approach** is also implemented so that the Fund's equity portfolio has an MSCI ESG rating:
   - For developed markets of at least BBB
   - For emerging markets of minimum BB.

As a result, the Fund has an ESG rating that generally ranges from AA to A, which puts it at the high end of the range for diversified flexible funds.

Macroeconomic environment

Growth

The economic damages of the current health crisis are major; in the United States, estimates predict that it will take about two and a half years to come back to the growth levels expected at the beginning of the year.

Although economic activity fell sharply in the second quarter, the speed and scale of the rebound observed in the third quarter were surprising.
This rebound is mainly due to the support measures implemented in most countries, so it is artificial growth and not an organic one.

It was initially planned that these measures would be phased out in the autumn but it is now clear that this will not be the case; some countries are even increasing them.
As long as these measures remain in place, the economy is expected to hold up, but it is unlikely that we will see a transition to strong organic growth in the private sector.

From a structural point of view, we can point to a number of trends, some of which have also been reinforced by the current crisis. These trends are, in our view, **impediments to solid organic economic growth.**

- **High levels of debt**

These levels are observed for both public and private debt. This is a trend that the current crisis has accelerated as the support measures put in place have increased public debt in the majority of countries. Numerous academic studies demonstrate the link between high debt and low growth.

- **Dynsfunction of the eurozone**

Unlike the United States, the euro zone does not meet the criteria for the optimal functioning of a monetary union. These criteria are: mobility of capital and labour, price and wage flexibility, relatively synchronised business cycles and finally a transfer of taxes ("fiscal union").
This results in significant divergences between Eurozone countries (e.g. in terms of industrial production), which leads to structurally weak growth and thus to an inability of the eurozone to act as a driving force in the global economy.

- **Geopolitical tensions**

The emergence of China as a second economic power is upsetting the United States; this problem goes beyond the divisive personality of Donald Trump.
In Europe, the tensions surrounding the Brexit issue also raise questions.
This climate is not favourable to business investment.

- **Slowdown in world trade**

In recent years, we have seen an rise in protectionist attitudes and increased recourse to tariffs; this trend could accelerate following the current health crisis, since there is now talk of repatriating certain production lines.

Absence of "creative destruction"

The starting assumption is that unprofitable businesses (cost of debt servicing greater than profits) need to disappear in order to allow others to prosper and thus create economic momentum.

However, in their desire to avoid a recession at all costs, the authorities keep interest rates extremely low and these so-called zombie companies do not go out of business, thus reducing the economic dynamic.

- **A growth model based on private consumption**

In the majority of industrialised countries, GDP growth mainly depends on private sector consumption (in the United States, it accounts for almost 70% of GDP).
For some time now, however, we have been seeing a trend towards an increase in the savings rate. The Covid-19 crisis has further accelerated this trend. If private consumption slows down, we will therefore see a slowdown in growth.
It remains to be seen whether this trend will reverse once the health crisis is behind us.

- **Growing social imbalances**

The very wealthy minority of the population has greatly benefited from the recent environment but, relatively speaking, this category of the population spends little and saves a lot, while the category likely to use an rise in their financial income to spend has not seen an increase in income.
These growing inequalities therefore constitute a brake on consumption growth.

➔ The economic system in which we are evolving has slipped into a vicious circle in which very low interest rates have led to inflation in the price of financial and real estate assets and, at the same time, to a decline in productive investment. The result is low economic growth and increased social inequalities, leading to a rise in populist policies whose measures are ultimately not conducive to growth.

Inflation

Inflation will surely be one of the factors to monitor in the coming years.

We have been in a disinflationary regime for 40 years and the question arises whether this situation will fundamentally change or not.
Those in favour of a return to inflation point to the extremely high monetary growth of recent months and the historical correlation between monetary growth and inflation.

Indeed, according to Fisher's equation, P*T=M*V[1] . It is therefore legitimate to think that if the money supply in circulation increases, prices will rise. However, since 2008 and the massive liquidity injections by central banks, inflation has not really picked up.
This is because since then the velocity of money has only been declining. In other words, **a lot of money has been created but most of it has never reached the real economy.**
Will this situation be reversed?

In the end, **the question here is whether the price regime will be determined in the future by the real economy or by political economy**:

- **Real economy** characterised by increased digitalisation and robotisation as well as a less dynamic consumption (what about the supply/demand situation post-Covid-19?) → disinflationary environment;
- **Political economy** characterised by a disappearance of the boundary between monetary and budgetary policy, by an increase in public expenditure financed by monetary growth → inflationary environment.

However, a distinction must be made between a short term horizon (where inflation will remain moderate) and a medium- to long-term horizon which could see a change in trend. In any case, the main indicator to be monitored remains the velocity of money.

Overview of financial markets

Fixed Income markets

The current crisis has confirmed or even reinforced a very low interest rate environment for a long time to come. Indeed, the US Federal Reserve does not envisage a tightening before 2023 or even 2025.

The evolution of long rates is normally determined by the market, but the monetary authorities have significant means at their disposal to influence it. Indeed, just as we are witnessing a shift from a market economy to a controlled economy, a similar situation is emerging on the financial markets. **In the current context of very high indebtedness, it is unlikely that central banks will allow long-term interest rates to rise durably**.
Moreover, the Federal Reserve has already indicated on several occasions that it could follow the example of Japan, which has pegged the 10-year rate to zero for several years now.

In conclusion, the fixed income asset class has become risky and unattractive. Indeed, **the risk/return profile of sovereign bonds has sharply deteriorated** (duration has increased and yields have strongly fallen).

For mixed strategies, the classic "50-50" allocation does maks sense anymore.
This is why, at the level of the BL Global Flexible EUR Fund, the investment principle is to consider the equity allocation as the performance driver and to combine it with assets that are able to protect the portfolio in the event of an equity market downturn.

Equity markets

Because of its scale and speed, the stock market rebound that began at the end of March is surprising given the exceptional dimension of the economic damage caused by this crisis and the uncertainties that still weigh on its evolution.
We are entitled to wonder whether the markets are not disconnected from reality**. At the same time, however, the crisis has endorsed a scenario of persistently low interest rates, a scenario that is a priori favourable to the equity markets.**

[1] Where P= prices, T= transactions, M= Money supply et V= velocity of money (speed of circulation of money supply)

Several prevailing trends have also been amplified by this unprecedented situation.

- **Outperformance of the US market and technology stocks**

The American market has outperformed the European market for several years, and the last few months have followed this trend.

If we analyse the performance of the US market in more detail, we also note that **this outperformance is mainly due to technology stocks**, notably the "Giant Caps" such as Facebook, Apple, Alphabet, Amazon, Netflix and Microsoft.
Indeed, the difference in performance between the S&P 500 index, based on market capitalisation (in which the above-mentioned stocks have a weighting of more than 20%) and the equally weighted S&P 500 index is particularly significant in 2020, with an increase of 5.5% for the former and a decrease of 4.7% for the latter.

- **The Value vs. Growth debate**

This debate is intimately linked to the topic of performance differences between the American and European markets. Indeed, the composition of the US market is essentially oriented towards sectors with growth characteristics (Technology in particular) while the weight of the so-called "Value" sectors on the European market is greater. Within the S&P500, the IT sector accounts for 27% whereas it represents only 5% of the MSCI Europe. Conversely, the weighting of the financial and energy sectors (which tend to underperform in the current context) is higher in Europe.
Generally speaking, **the weight of cyclical sectors in the S&P 500 has only decreased in recent years. The S&P 500 index has thus taken full advantage of existing structural trends such as digitalisation or e-commerce.**

This debate also remains important for our investment style since, due to our investment methodology oriented towards quality, we tend to avoid the typically "value" sectors such as Finance, Energy and Commodities.

The question finally comes back to whether it is better to pay a premium for superior fundamentals or a discount for inferior fundamentals. It is clear that **quality companies have been largely outperforming in recent years. However, this outperformance makes sense**. Indeed, these companies can be considered as high-duration stocks as they are often active in rather defensive sectors and thus show good earnings visibility. As such, **they benefit disproportionately from a very low interest rate environment**. Conversely, lower quality companies, which are often those falling into the "value" category, often face structural problems and are in particular much more affected by the crisis.

- **Structure of equity market returns (S&P500)**

Equity returns over the past decade have been particularly high. Decomposing this return into its various components gives us an idea of what we can expect from the current decade.

The total return of equities is the result of price appreciation and dividends. The two components in price appreciation are earnings per share and the multiple that investors are willing to pay for that earnings. Earnings per share is a function of the development of sales and profit margins and the increase/decrease in the number of shares outstanding.
By breaking down the S&P 500 index return into these different components, we see that **a significant portion of this return is due to increased profit margins, share buybacks and higher valuation multiples.**

Will this breakdown continue in the coming years?

→ The evolution of companies' **revenues** as a whole depends to a large extent on the global economic situation, and a strong acceleration of the latter is not a priori foreseen.

→ The **profit margins** of companies are now historically high and the trends observed at the political level point more in the direction of a search for a better balance between capital and labour through measures favourable to the latter.

→ In a low interest rate environment, **share buybacks** should in principle continue unless companies find better investment opportunities in their business. However, in some sectors that have called for public support, these buybacks could become more politically sensitive.

→ The evolution of **valuation multiples** is probably the most difficult component to anticipate as it is partly influenced by psychological factors. Some valuation ratios point to historically overvalued markets. However, unlike the situation in the early 2000s during the technology bubble, high valuation levels can now be rationally explained by very low interest rates (making fixed income investments less attractive).

Gold and gold-related companies

Gold is an important component of the portfolio.

Since the financial crisis of 2008, gold price has massively underperformed the US market. We believe, however, that a**ll the conditions are now in place for a structural rise in gold price**, including: excessive money creation, central banks determined to create inflation, negative interest rates in real (inflation-adjusted) or even nominal terms, an easing of fiscal austerity, growing geopolitical tensions and the rise of populism. Central banks have no credible plan to return to traditional monetary policies and governments seem increasingly tempted by expansive fiscal policies financed by money creation.

Gold companies will benefit from a structurally rising gold price, especially since their main production cost, energy, is currently low. The low valuation of these companies shows that many investors remain sceptical of them, which is understandable in view of their past mistakes. It is therefore important to be very selective in the selection process.

An investor interested in these companies should never underestimate their volatility and the fact that, at times, they are more correlated to the stock market than to the price of gold.

To sum up

For several years now, we have been operating in a **structural framework characterised by positive (albeit moderate) growth and low inflation**. Such an environment is generally favourable to equities. Recent events have not drastically altered this structural configuration, although our conviction is less strong and it is not excluded that we may move to an environment of lower growth and/or higher inflation.

The economic and financial environment is currently giving contradictory signals to investors.

- On the one hand, the combination of an abundant supply of liquidity from central banks and a weak demand for liquidity from the real economy continues to argue in favour of a further rise in financial markets.
- On the other hand, uncertainties about the global health situation, the outcome of the presidential elections in the United States and, more generally, the fragility of the global economy call for caution.

Long-term investors should **review their perception of risk.**

- **At present,the main risk today is not volatility, but the possibility of permanently losing part of one's capital. From this point on, real assets such as shares should be preferred to monetary assets.**
- **At the stock market level**, the tyranny of indices should be avoided. It will be a question of **being selective** and not giving in to the temptation to sell quality companies in favour of poorer companies under the pretext that the discount of the latter in relation to the former is historically high. The Covid-19 crisis has indeed further accelerated the gap between winners and losers.
- **Gold continues to have its place in a diversified portfolio**. The yellow metal remains an insurance against the risk of irresponsible monetary and fiscal policies. Gold companies are attractive as long as they are highly selective and able to cope with their **volatile nature**.

Portfolio positioning

At the beginning of the year, the portfolio's **cash** position was important (around 1/3). In March, the manager took advantage of the correction on the global stock markets to put this liquidity to work and increase the **equity weighting** while at the same time implementing a partial hedge of the equity risk in view of the uncertainties surrounding the extent and duration of the crisis. This hedging has been a hindrance due to the rapid and massive recovery of equity markets but remains in place for the time being in the context of renewed tensions on the health front and the upcoming US presidential elections.

The **bond pocket** has been slightly increased in August via long term US Treasury bonds indexed to inflation. This position could be strengthened in the medium term.

Given the positive structural environment for gold, investments in **gold-related companies** increased to the maximum limit of 15%.

At end of September 2020, the allocation is the following:

- Equities
  - Gross exposure: 63%
  - Net exposure: 49.7%
- Bonds: 4.6%
- Gold: 14.4%
- Cash: 18%

The **sector allocation** of the equity bucket is in line with the implemented management style, i.e. absence of the Financials and Energy sectors and a significant weighting of the Industrials, Consumption-related, Healthcare and IT sectors (with the latter balanced between solid fundamentals and valuations that have risen significantly).

In terms of **currency allocation**, the Fund Manager hedges the majority of its USD exposure; this is not a positioning linked to a strong conviction on the direction of the dollar but rather a desire to increase the weighting of the euro, the Fund's reference currency, in the portfolio so as not to increase the portfolio's volatility.
Exposure to the Yen and Swiss Franc is maintained as these currencies are considered safe haven currencies and help to protect the portfolio when markets become more difficult.

Within the **gold pocket**, the Fund Manager adopts a "**Best-in-class**" approach, i.e. in addition to traditional financial factors, he also takes care to select companies with an above-average ESG score (with particular emphasis on carbon intensity and social score). In the same spirit, the manager is selective in terms of the location of reserves, which must be in geopolitically stable countries.

Performance review

On a YTD basis (to end September 2020), the Fund has recorded a positive performance (2.8% for the S share class) against a decline of -3.6% for the average of its Lipper category and a decline of -3% for the global equity markets (MSCI World NR).

Since launch, the Fund is in the 1st quartile of its Lipper category with a performance of 22.8% (vs. -0.5%) and a volatility of 7.79%. Over the same period, the global equity market (MSCI USA NR) appreciated by 20.5% with a volatility of 18.3%.

In terms of **individual contributions** to the equity pocket :

The **main positive contributions** came mostly from more defensive or technology companies.

- *Nintendo*
- *Taiwan Semiconductor*
- *SAP*
- *Sysmex*
- *Givaudan*
- *Techtronic*
- *Reckitt Benckiser*
- *Cloros*
- *Nabtesco*
- *Croda*

The **main detractors** are generally more cyclical stocks

- *JC Decaux*
- *DCC*
- *Lowes*
- *CK Asset Holding*
- *Coca Cola Femsa*
- *SATS*
- *Danone*
- *FEMSA*
- *CCU*
- *GLORY*

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