

## **Global Equities – Intra-generational investing**

In our view, the best prospect for outperforming the World Equity Index is to invest in a concentrated, high conviction portfolio of equities and operate a very long investment horizon.

In a world short of legitimate arbitrage opportunities, being able to hold investments for longer than other market participants remain one of the very few ways to gain an edge. The proliferation of information sources, increased market access and reduced trading costs have increased activity but have added little, if any, true investment value.

We observe that that the spread over cost of capital enjoyed by leading companies (sometimes referred to as the excess return) often remains more persistent than traditional economic theory would allow.

This has been aided and abetted by the spread of solid management theory, the proliferation of “management” as a subject which can be studied and taught, the deployment of multiple technologies and the intermeshing of the global economic system.

In the world of equity investment, it is companies not countries that have become the key. Origin and domicile has come to mean progressively less. The companies we invest in are variously domiciled in Switzerland, Denmark, Sweden, the US, UK, France, Spain, Holland, Germany, Japan and South Korea but the country of their incorporation is a near irrelevance as often is their home market sales base.

Valuations contain relevant information and valuation at purchase has a significant bearing on the ultimate return. Given return expectations being measured over the longer term, striving to identify and acquire high-quality companies at attractive or fair prices, becomes paramount. Purchases of candidate investments trading at challenging valuations therefore should be eschewed until valuations moderate. This approach to valuation can be defined as Growth at a Reasonable Price (GARP).

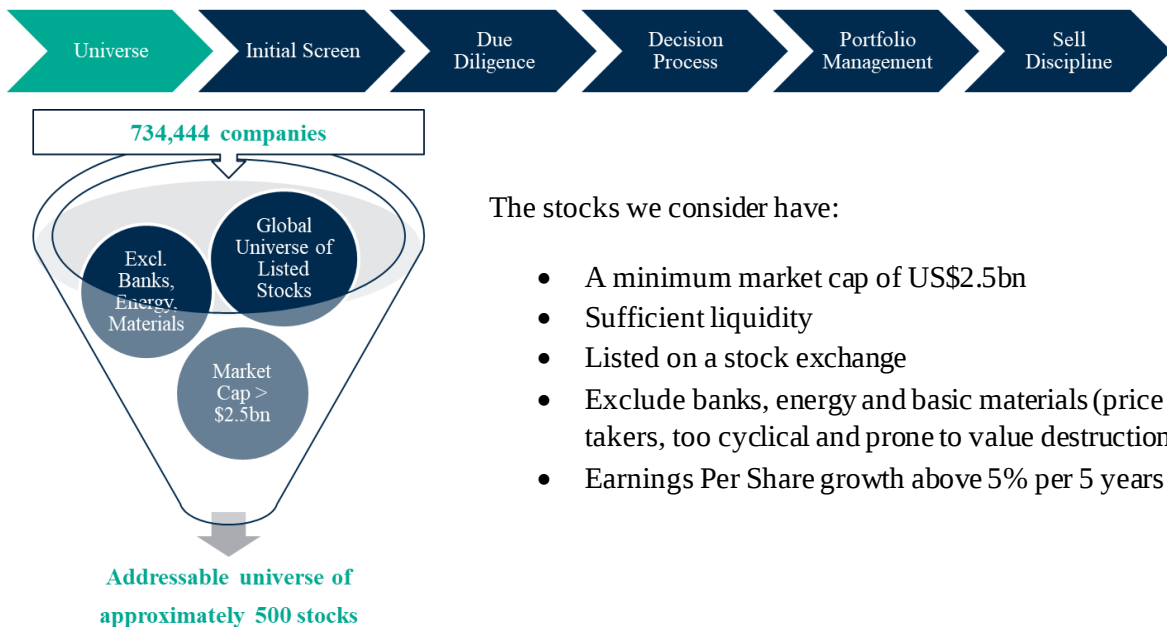
At Cerno Capital, we call this strategy Global Leaders, and it defines our approach to equity investment.

### **Investment Criteria**

#### **Seven factors for identifying great global companies:**

1. Industry leadership- strong and defensible competitive position
2. Management with high level of integrity
3. Above sector average growth prospects
4. Cash generative- cash returns delivered at significant excess to their cost of capital
5. Revenue derived from multiple markets or growth market exposure
6. Companies with robust balance sheets and low leverage
7. Attractive valuation at time of purchase.

Only companies with sufficient liquidity and those offering income streams from a diversified set of economies are desired; therefore, companies whose revenue streams are concentrated to one region or country with no plans to expand their focus are excluded. There are some industries where we believe it is very difficult, if not impossible, to build a sustainable competitive position and it is unlikely those sectors would feature in the Cerno Global Leaders Strategy. This particularly applies to the banking, energy and basic materials sectors.



The stocks we consider have:

- A minimum market cap of US\$2.5bn
- Sufficient liquidity
- Listed on a stock exchange
- Exclude banks, energy and basic materials (price takers, too cyclical and prone to value destruction)
- Earnings Per Share growth above 5% per 5 years

The captioned requirements generate a long list of approximately 500 companies.

The universe is qualitatively screened for companies demonstrating the investment team's key criteria; in particular those offering a wide and sustainable competitive moat within their respective industries. Thereby, judgements are also made on the industry structures that companies operate in and the likely sustainability of the industry structure. By structure, the extent of competition within an industry is referred to; is there a monopoly, duopoly, oligopoly, or rather lots of smaller players each with a small market share?

Favoured companies tend to operate in an oligopolistic environment where a few players dominate the industry. Therefore, although the investment universe is not restricted by market cap other than to ensure sufficient liquidity, cursory analysis leads the process towards the mid- and large cap space, as those types of companies tend to hold a high market share within their sector.

## Summary

Sustainable businesses with long term competitive advantage appear to transcend short term style bias and solidify their positions in times of economic turbulence. The median incorporation date of the companies within the Cerno Global Leaders strategy is 1922. These are companies that innovate, have strong balance sheets, devour technology as leaders in their industries but perhaps more importantly, adapt to the fast-changing nature of Global markets.

The strategy well reflects the long-term nature of intra-generational wealth.