C WORLDWIDE

INSIGHT

Downside Protection In The Real World

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Today, many investors are searching for alternatives to zero or negative rates on savings but have been hesitant to invest in equities because of the higher risk. However, if you are willing to take some equity risk, stable equities might have a place in your investment portfolio. Stable equities typically offer a more stable return as one invests in companies with a stable and more predictable earnings. Perhaps most surprisingly, stable equities as an asset class have provided long-term investors equity market returns, but with lower volatility.

Managing risk

Humans generally look to reduce risks in their lives. This leads us to buy insurance on our houses and cars and wear seatbelts when we drive. The same desire for protection can be seen in the investment world, where the volatile stock market presents us with the risk of loss of capital. In our Stable Equities product, we focus on managing that risk by investing in companies with a stable earnings history and a moderate, but predictable growth trajectory.

Winning by reducing capital loses

Big drawdowns leave investors with a lot of catching up to do to get back to their original wealth. Since the risk tolerance of most investors is asymmetric, it is even more important to consider strategies that tries lower the downside risk while at the same time pursuing strategies that participate in rising markets.

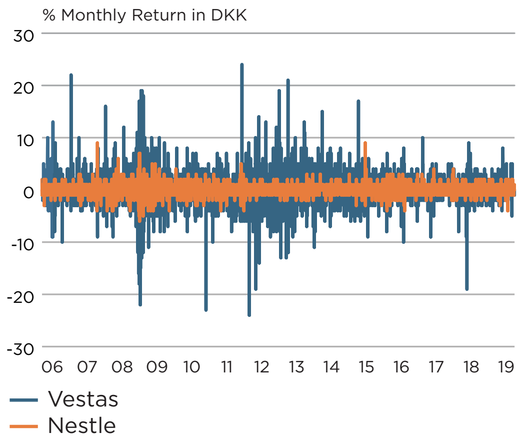
In C WorldWide Stable Equities, we invest globally and diversify our investments in different regions and sectors to lower individual security risk. We look for companies that are exposed to different risks, have little business overlap and generally low sensitivity to the economic cycle. Examples of these are telecommunications in Hong Kong, rental housing in Germany, utilities in North America, food producers in China, health insurance in America and global software companies. When investing in companies that primarily sell products or services that are consumed on a daily basis, the noise from the ongoing news flow about economic or political developments becomes less important. Our consumption of coffee, toothpaste, insurance, phone service or electricity is relatively unaffected by the changes in the economic outlook or the emergence of a political or geopolitical crisis. This investment approach tends to offer lower volatility and makes timing of market entry less important.

> **Since the risk tolerance of most investors is asymmetric, it is even more important to consider downside protection strategies while at the same time pursuing strategies that participate in rising markets.**

Stability versus volatility

This can be exemplified by looking at the return of investments in Nestle and Vestas over a 13-year period. This was a time period when both companies had strong performance, each rising more than 380%. Nestle produces food and beverage products that are consumed every day, such as coffee, water, chocolate, baby food and pet food. The predictability of Nestle's revenues translates into low share price volatility as shown below (the orange bars show monthly returns).

What is Risk?



Source: Bloomberg as of 28. Feb. 2019

All numbers are historical based returns. Historical returnes is no garantee for future returns. Returns will change due to daily savings.

Vestas has been one of the most successful companies within the wind turbine industry. Unlike the predictable nature of Nestle's business, Vestas' business model has been dependent upon government subsidies and orders are typically large and lumpy. Furthermore, Vestas needs to reinvest a large part of its cash flow to sustain the business. This has made earnings fluctuate and thus also the share price as shown in the graph above (the grey bars show monthly returns). Nestle is in our portfolio due to its strong product portfolio and stable earnings profile, whereas Vestas is not part of our investment universe due to the high share price volatility, which adds unnecessary risk to the portfolio.

Stability has historically been rewarded

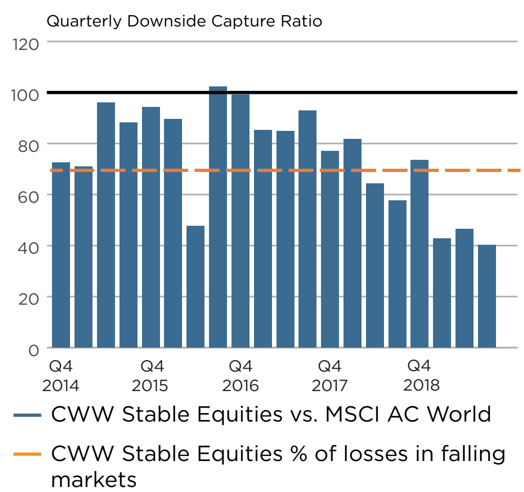
Looking at the performance of C Worldwide Stable Equities since inception in October 2014, the fund has had markedly lower volatility than the global stock market. In the graph below, the Fund's performance in rising markets (upside capture) and falling markets (downside capture) are shown. On average the fund has captured approximately 80 % of the upside in rising markets, but only 75 % of the downside in declining markets.

Although the Fund has not fully kept pace when global stock markets are rising, the Fund has fallen less when markets are in decline. As compounding is significantly hurt by equity losses, the Fund has ended up with superior returns compared to the general index over its lifetime. This is why risk management is a top priority for us and our analysis shows that a stable compounding portfolio can match the performance of the global stock market with lower risk (measured on beta, standard deviation or maximum drawdown).

A downside protection strategy will most likely lag in bull markets driven by an improving global economy accompanied

Figure 2

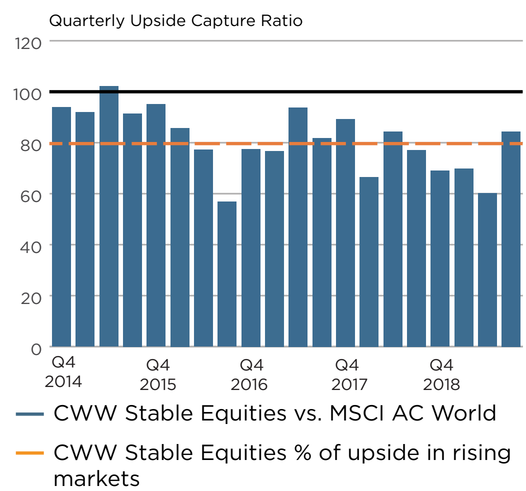
Downside Protection



Source: Factset of Sep. 2014 - Jan. 2019

Figure 3

Upside Capture



Source: Factset of Sep. 2014 - Jan. 2019 with rising interest rates. In these periods, cyclical companies see strong earnings improvement and their multiples expand, whereas the non-cyclical companies keep growing earnings more steadily. Rising interest rates generally put pressure on lower risk companies, because they have long duration assets that will be discounted with a higher interest rate and bond yields become more attractive as an alternative as interest rates rise.

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Many investors are inherently tempted by a good investment story or the dream/hope of a fast pay-off by investing in a single stock while ignoring its high risk potential. When seeking a more predictable outcome, we manage a diversified portfolio of companies with stable and more predictable earnings that can withstand the unexpected, thereby better protecting the invested capital. C Worldwide Stable Equities is built on this idea of trying to lower the downside in falling markets while still enjoying the long-term benefit of steadily growing earnings among global companies. Since launch of the fund, the strategy has achieved a higher return than the global stock market while taking a lower risk. However, please note that theory and history are not a guarantee for future returns.

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