FLAGSHIP
ASSET MANAGEMENT

Navigate Safely Forward

Q3 2022

Investing through a bear market

The Path Forward

The 27th bear market since 1929

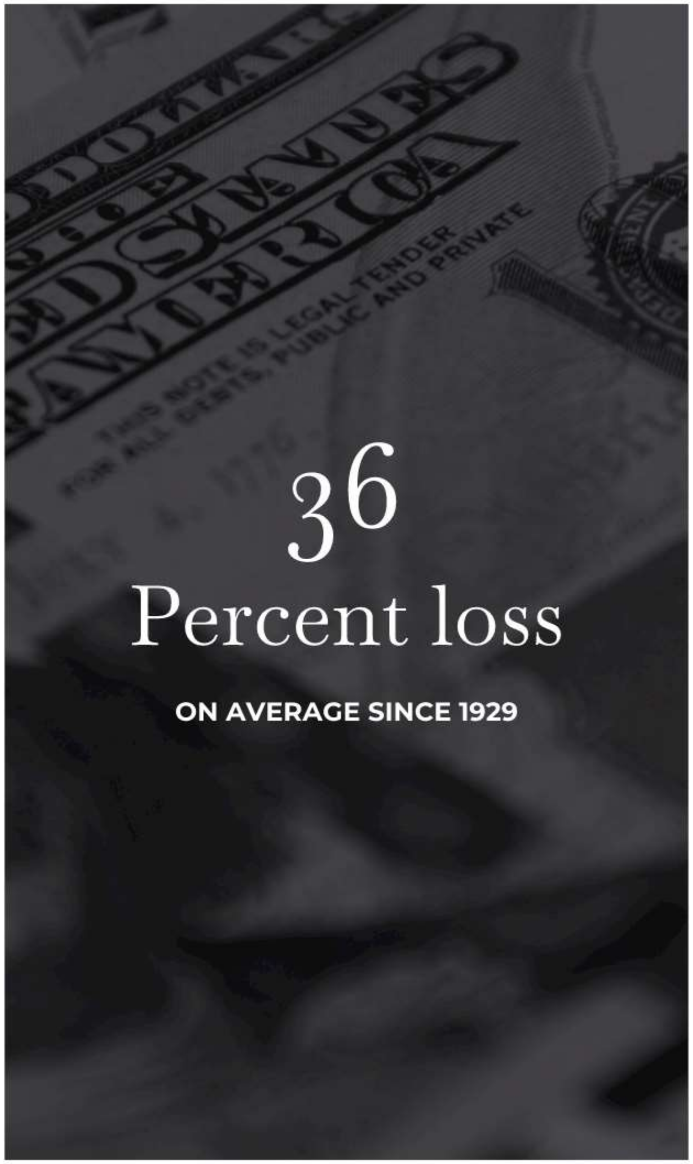
We are entering the last quarter of what has been one of the **toughest** years in memory for financial markets

As long as core **inflation** continues to rise, we will continue to see weak asset markets

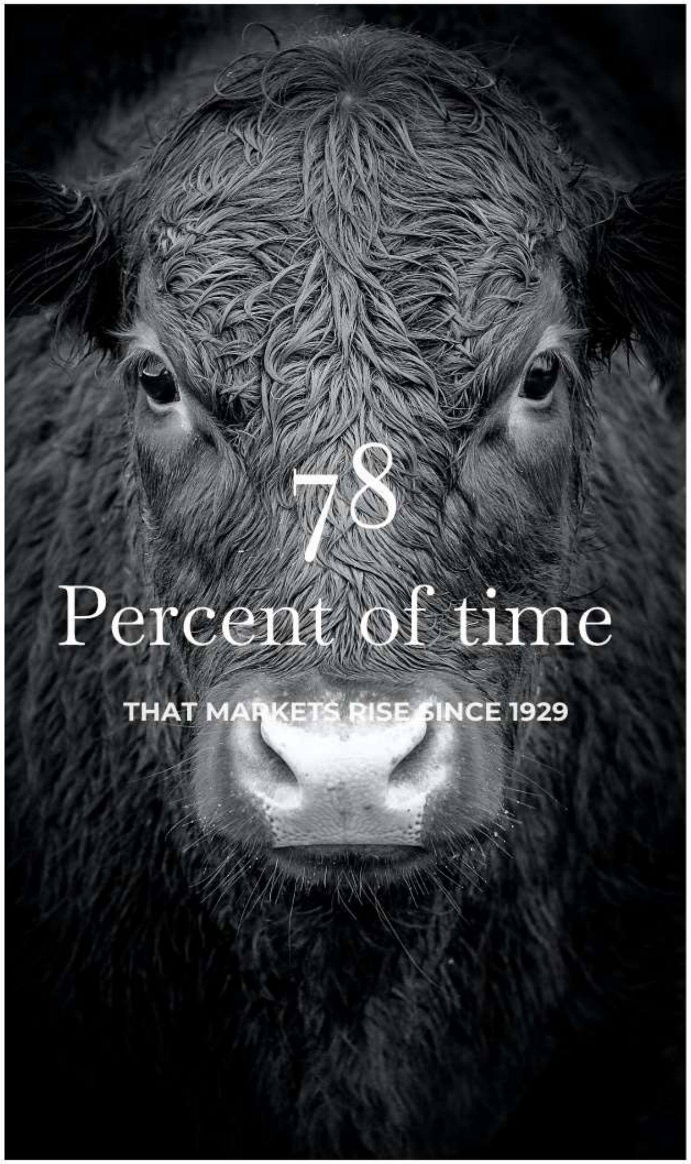
Interest rates remain on an upward trajectory

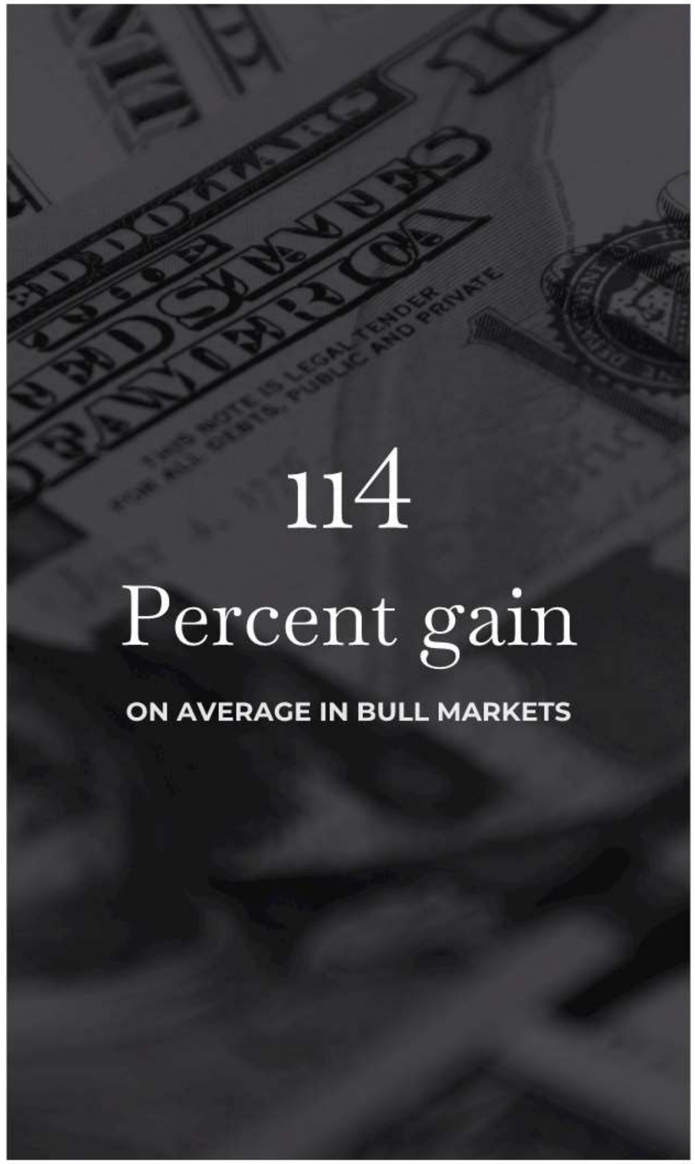
We remain **cautiously positioned** with considerable dry powder to apply into falling markets

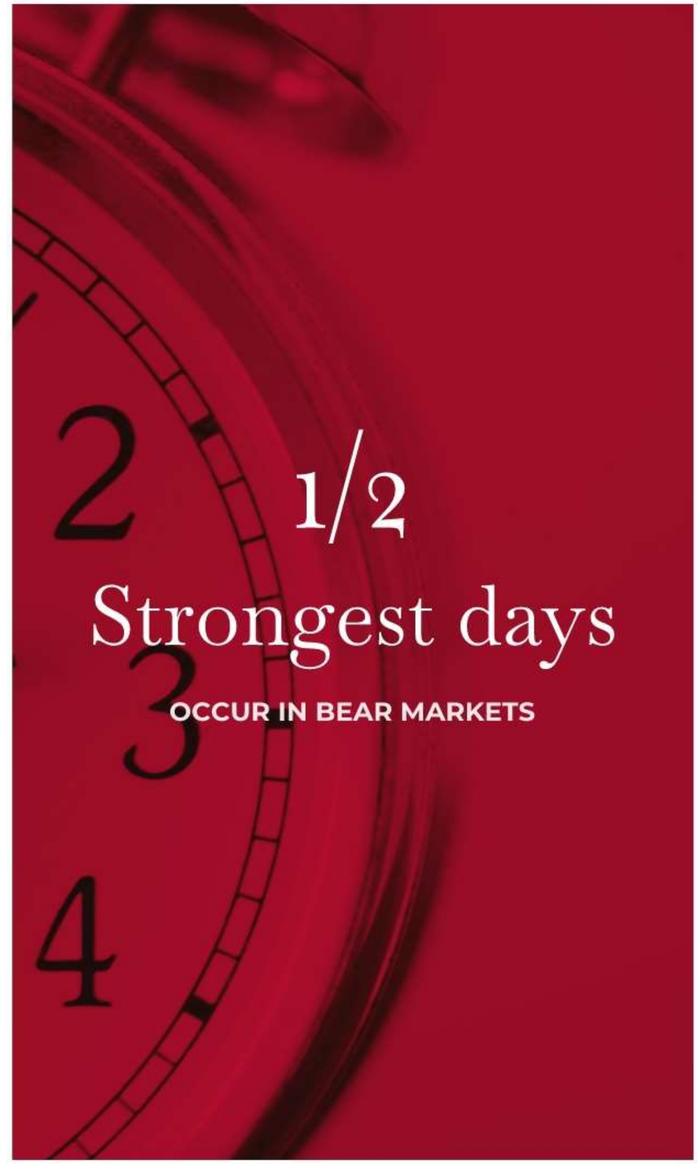

26
Bear markets
SINCE 1929


36
Percent loss
ON AVERAGE SINCE 1929


10
Months long
ON AVERAGE SINCE 1929


78
Percent of time
THAT MARKETS RISE SINCE 1929


114
Percent gain
ON AVERAGE IN BULL MARKETS


1/2
Strongest days
OCCUR IN BEAR MARKETS

What's happening?

An extraordinary confluence of economic and geopolitical risk

1. Environment is emotive and negative

2. Inflation remains the key variable

3. Tightening speed & magnitude are severe

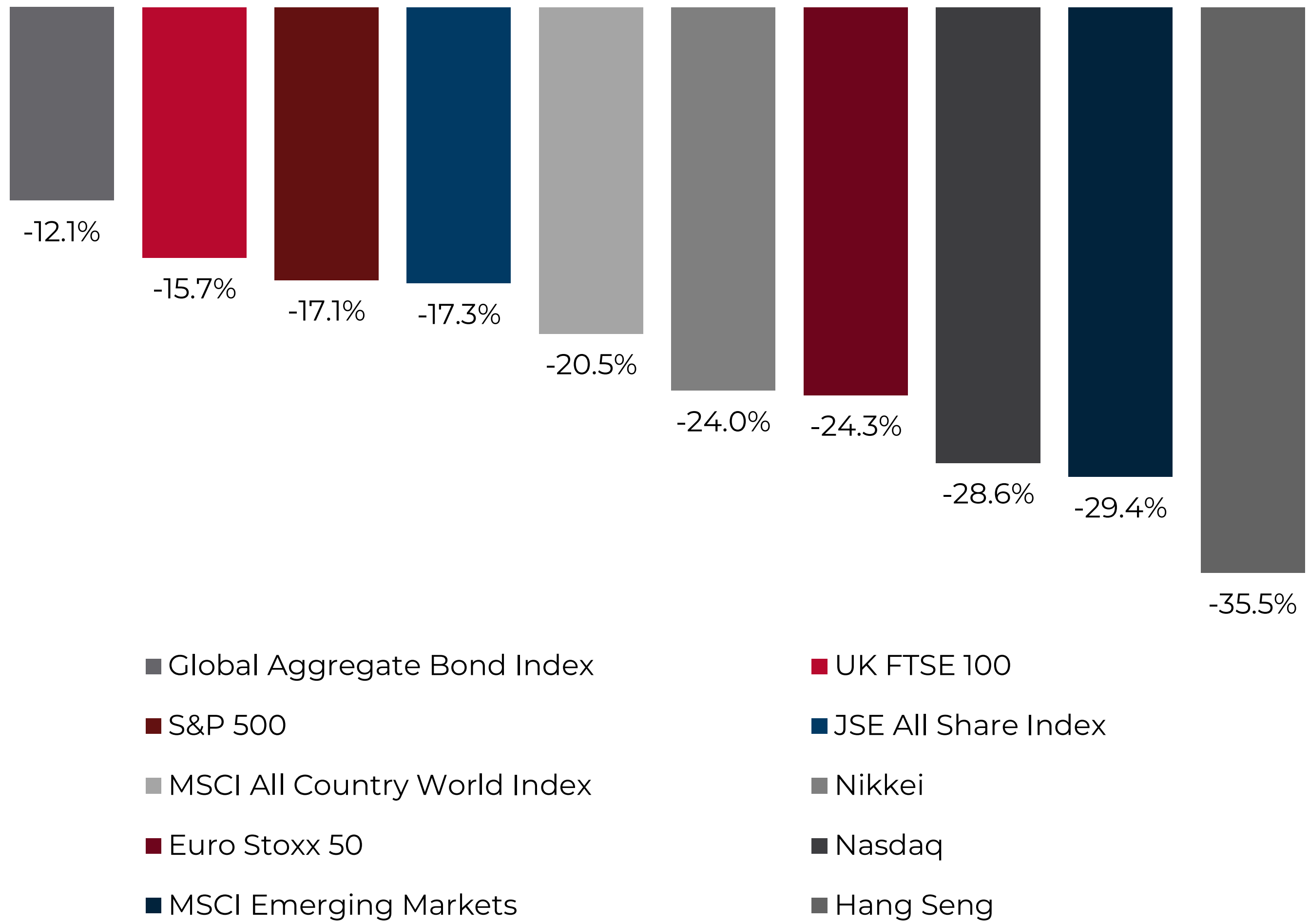
4. Next stage is a slowing of activity

5. Asset allocation - what are we doing?

6. Equity selection - where are the opportunities?

Asset Class Returns

YTD (USD)



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- Gauge of mortgage applications slips to lowest since 1999

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September 28, 2022 at 4:30 PM GMT+5:30
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CNBC

US TREASURYS

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Alexandra Semenova · Reporter
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Markets

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- Stoxx 600 to close the year at 406 points: monthly survey
- Strategists lowered their targets further since September poll

By Michael Msika +Follow
October 24, 2022 at 10:30 AM GMT+5:30

No 'adults in the room': Xi Jinping catches global investors off guard

Exclusion of moderates from China's leadership spurs record stock outflows

The next phase of Putin's invasion

Vladimir Putin will annex four regions of Ukraine on Friday, in an escalation of its invasion of Ukraine

Russia's intimidating 'dirty bomb' claims

Putin's nuclear threats aim to scare Ukraine and allies into backing down

US stocks and bond yields drop after GDP rebounds

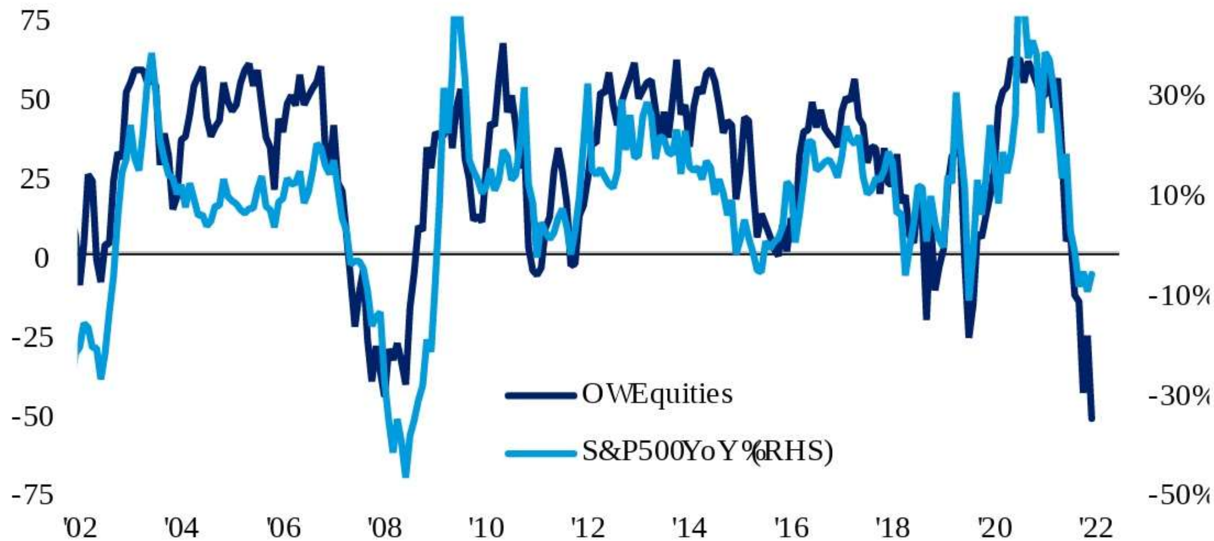
Shares in Meta slide more than 24% after Facebook owner reports another quarter of declining revenues

German president Steinmeier admits 'bitter failure' of policy on Russia

Ceremonial head of state's mea culpa reflects the shock Putin's war on Ukraine has had on the 'old ways of thinking'

Asset Allocation to Global Stocks at All-Time Low

Chart: Net % of investors that are overweight/underweight equities vs YoY change in S&P500 returns



Alan McGuinness
@Alan_McGuinness

My son has lived through four chancellors, three home secretaries, two prime ministers and two monarchs.

He's four months old.

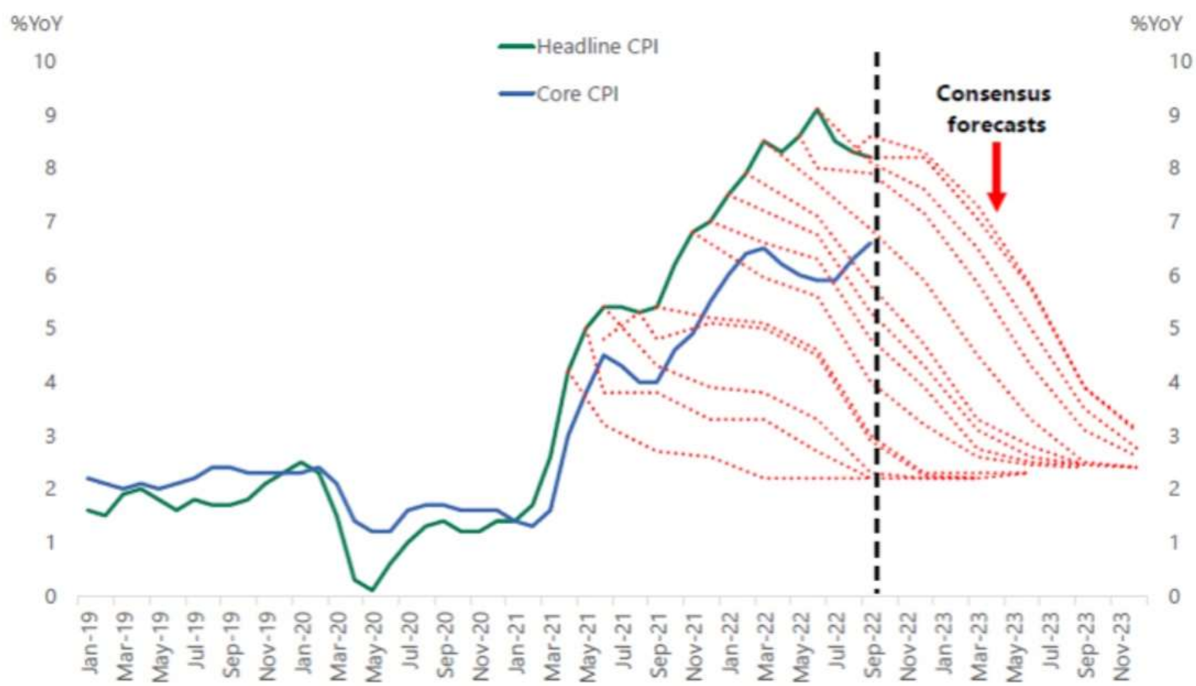
7:07 PM · Oct 19, 2022 · TweetDeck

Inflation continues to rise...

...driven by core components

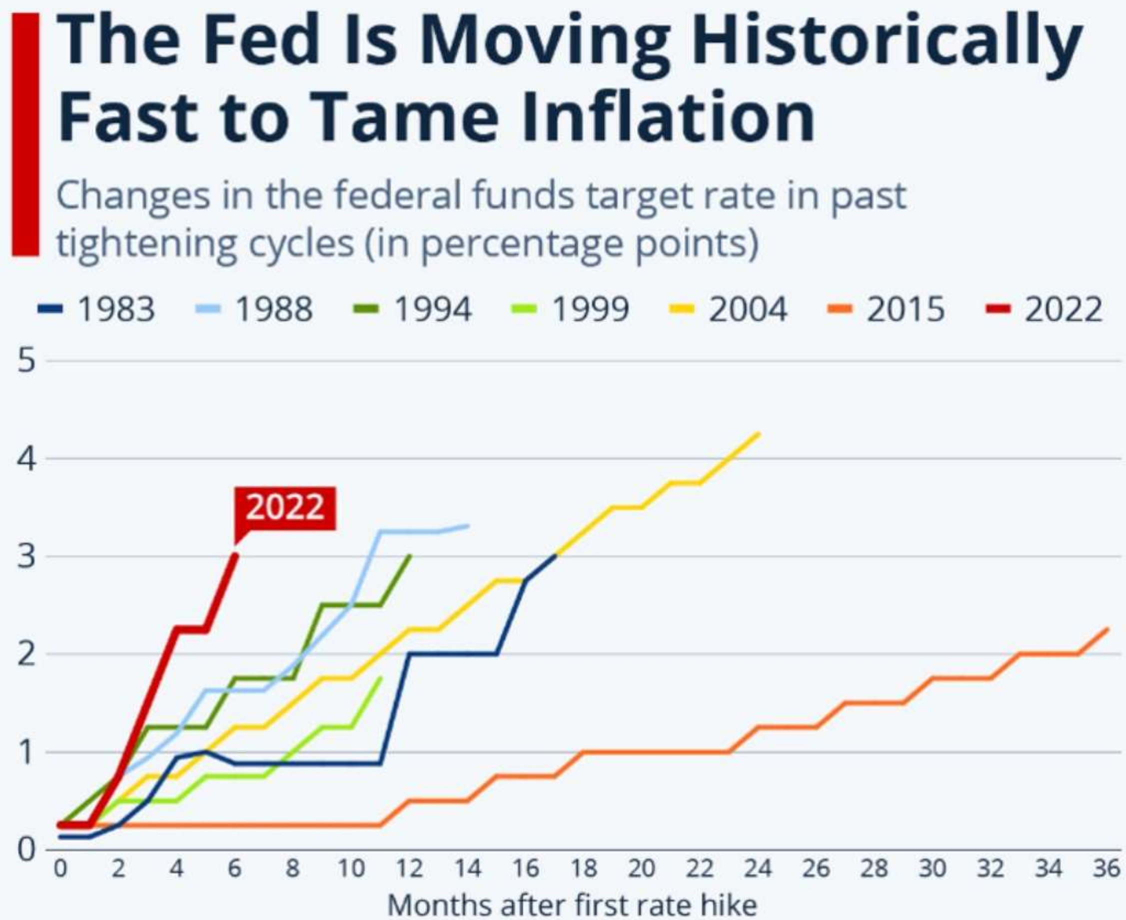
Defying forecasters

The consensus has been systematically wrong about inflation coming down

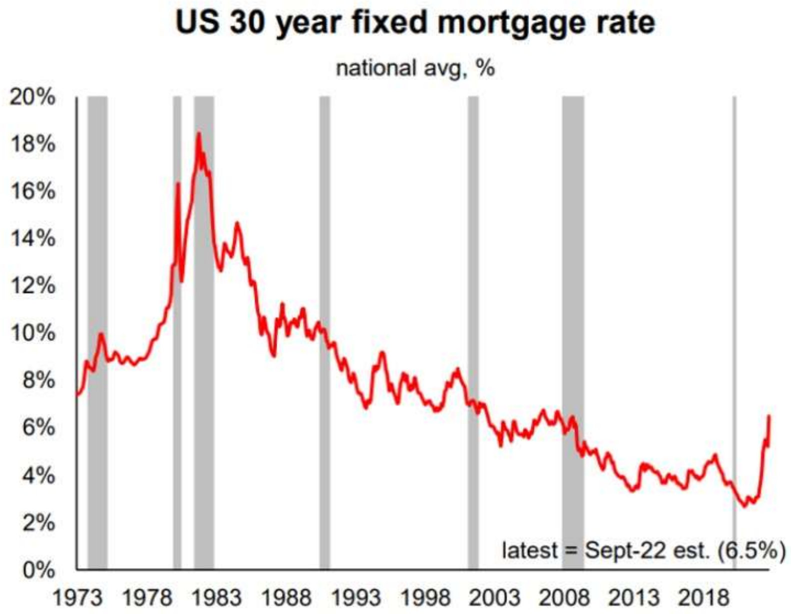


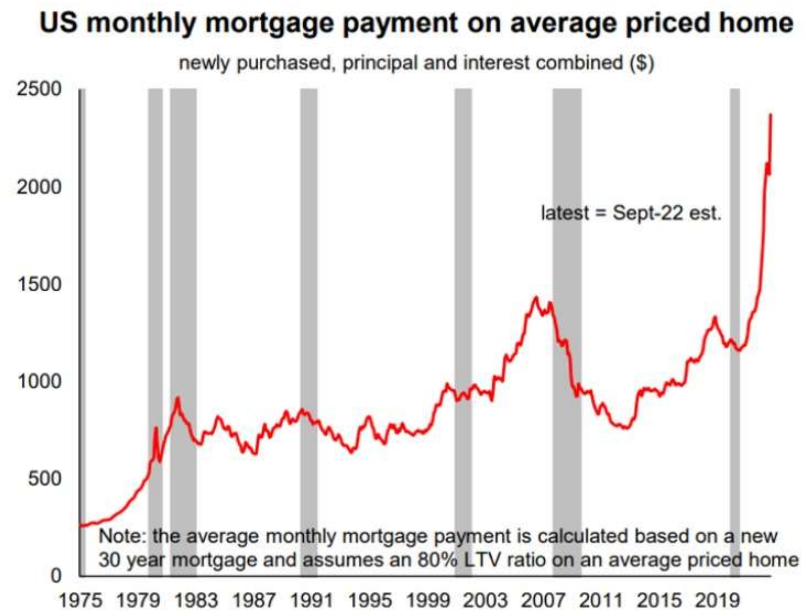
The Fed is moving fast

Indications are that the Fed will continue to tighten in its upcoming meeting



Stresses only now emerging in US





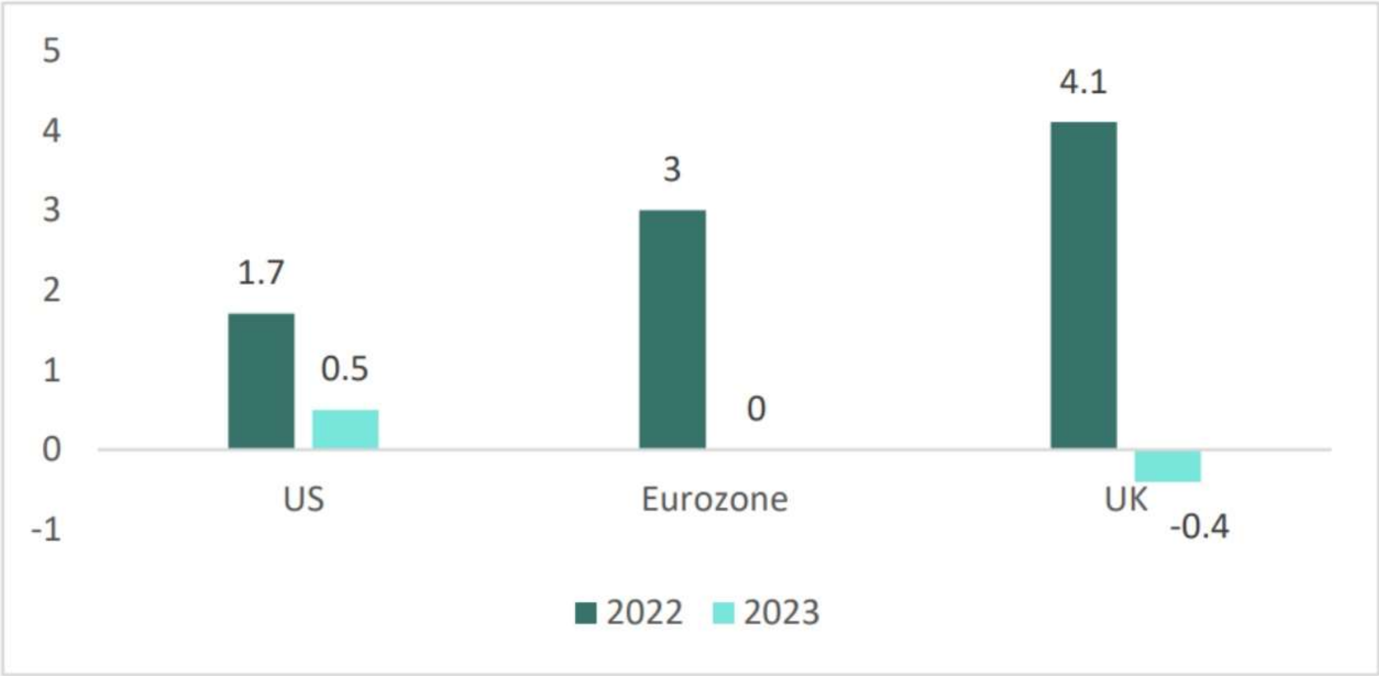
As well as elsewhere

It would be rare if the US manages to avoid a recession while the rest of the world enters one

GDP GROWTH

EXHIBIT 12 : **Real GDP growth forecast for 2023 is much lower than pre-Pandemic average levels in the US. For Eurozone, it has reduced to 0 and real GDP contraction is expected in the UK.**

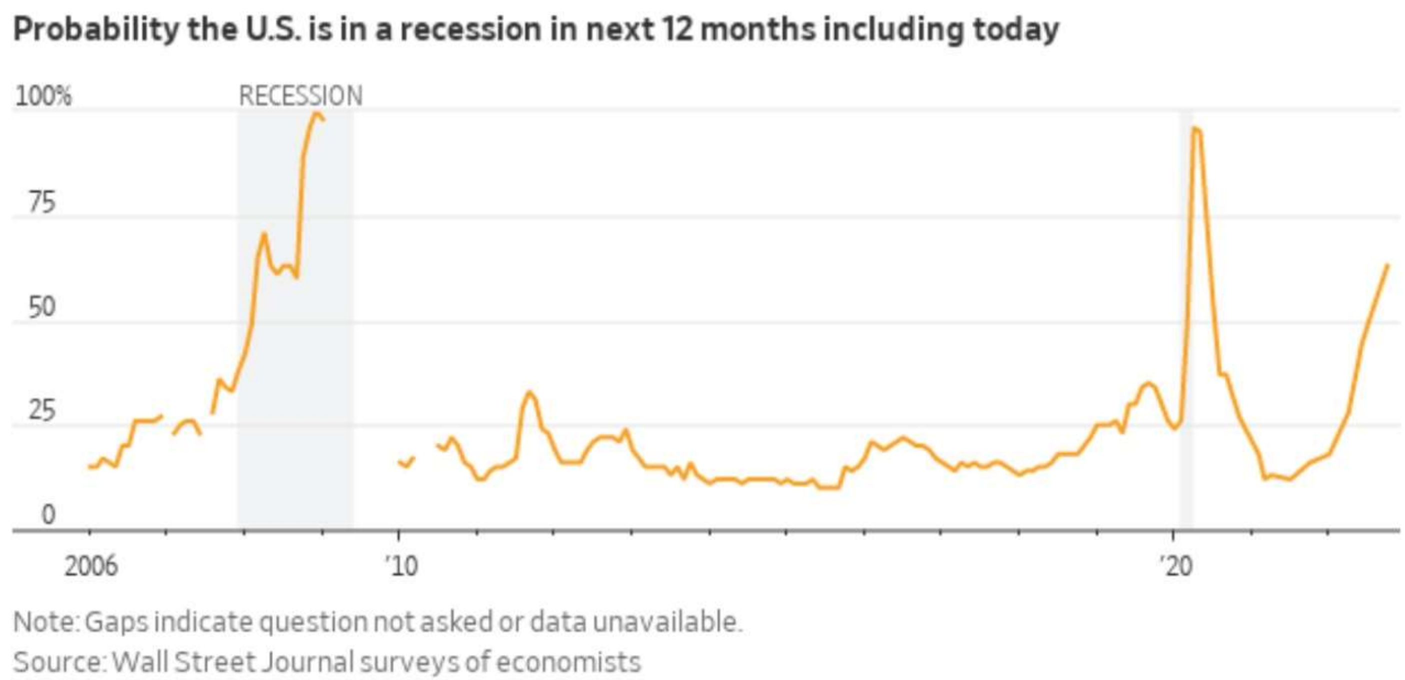
Real GDP growth yoy% consensus expectations



Source: Bloomberg, Bernstein Analysis

Forecasters seem to agree

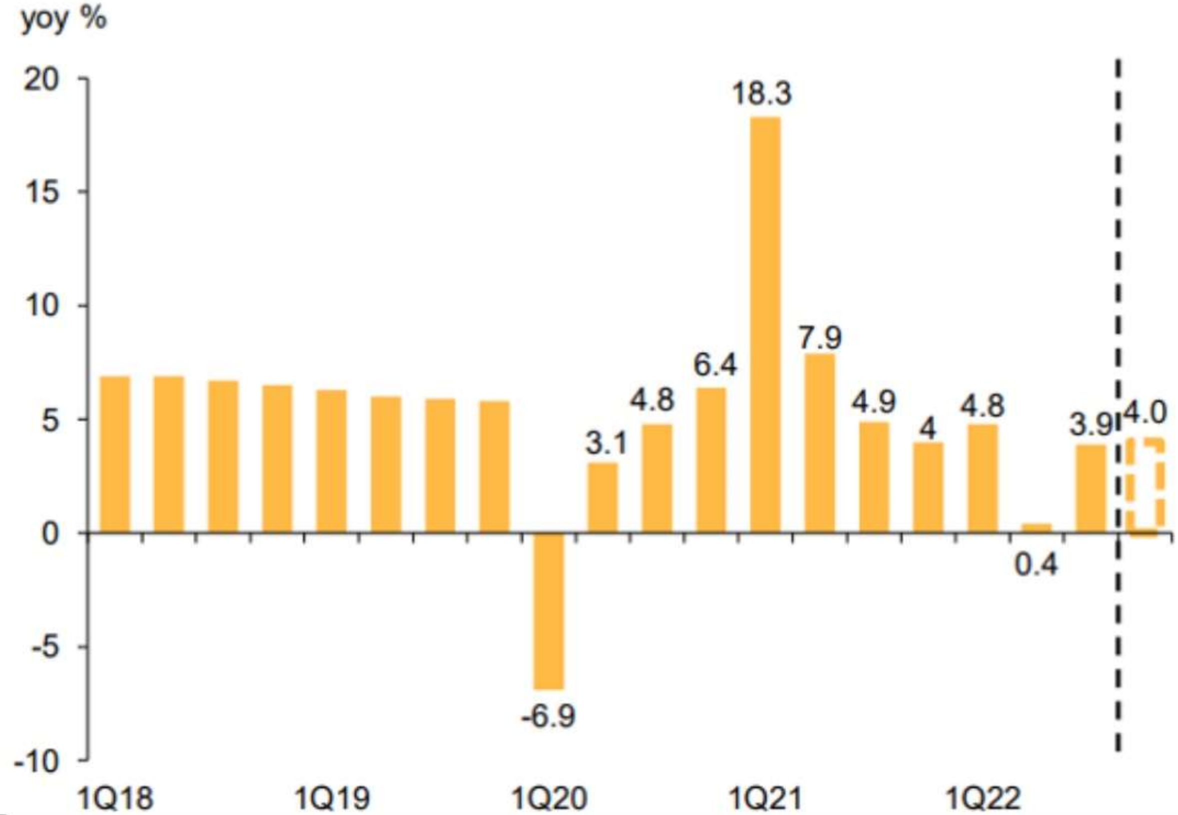
A broad slowdown seems likely to us, and likely a recession as well.



China is a wild card

China faces a number of key issues relating to it property markets and export sector.

Fig 1 GDP growth and forecast



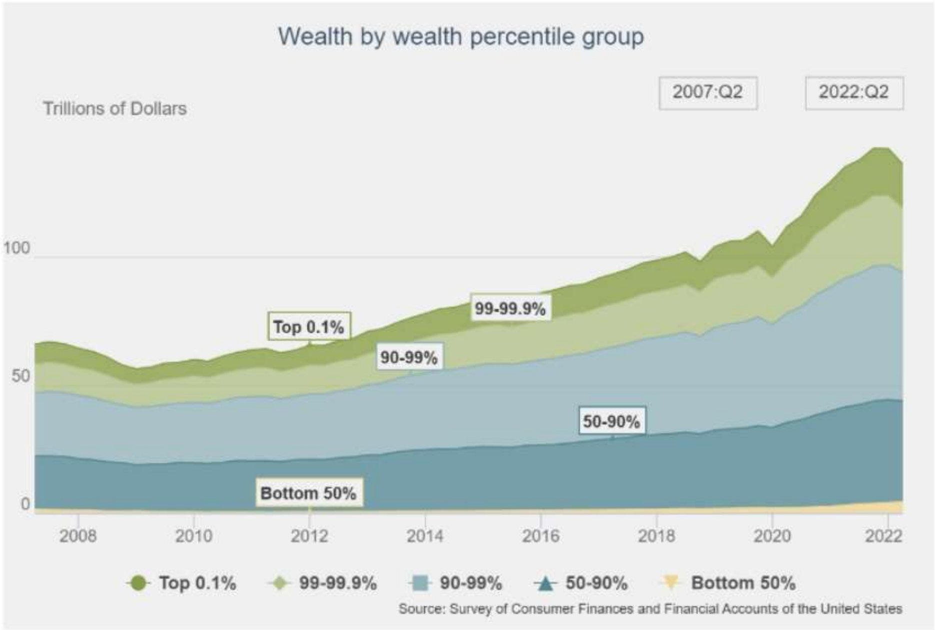
Why isn't inflation falling?

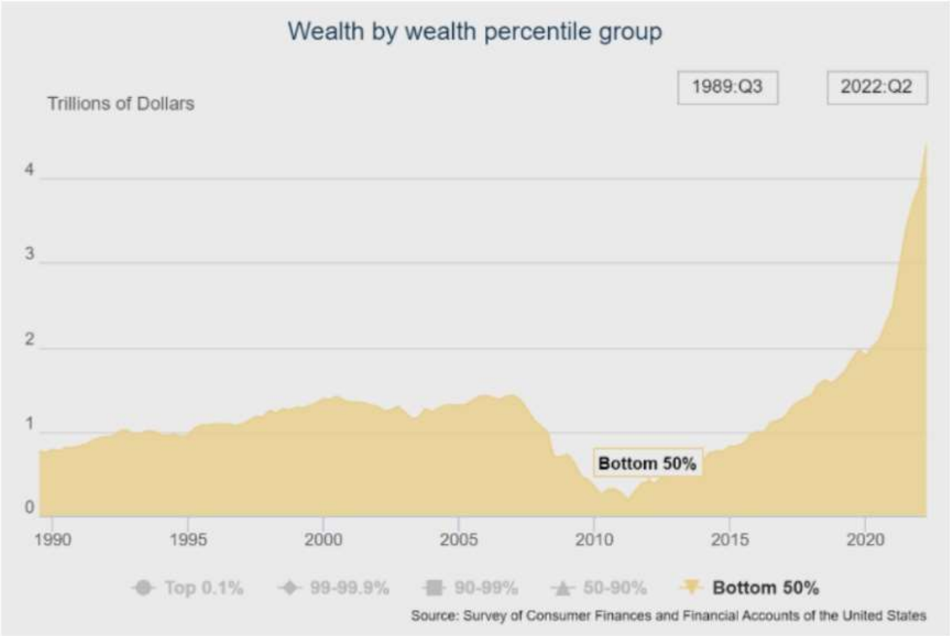
7 months in a row of inflation above 8% has not happened since the early 1980s

Month	CPI %
March	8.50%
April	8.30%
May	8.60%
June	9.10%
July	8.50%
August	8.30%
September	8.20%

(1) Everyone is wealthier

The U.S. consumer has likely never been more prepared for high inflation (and a potential recession)

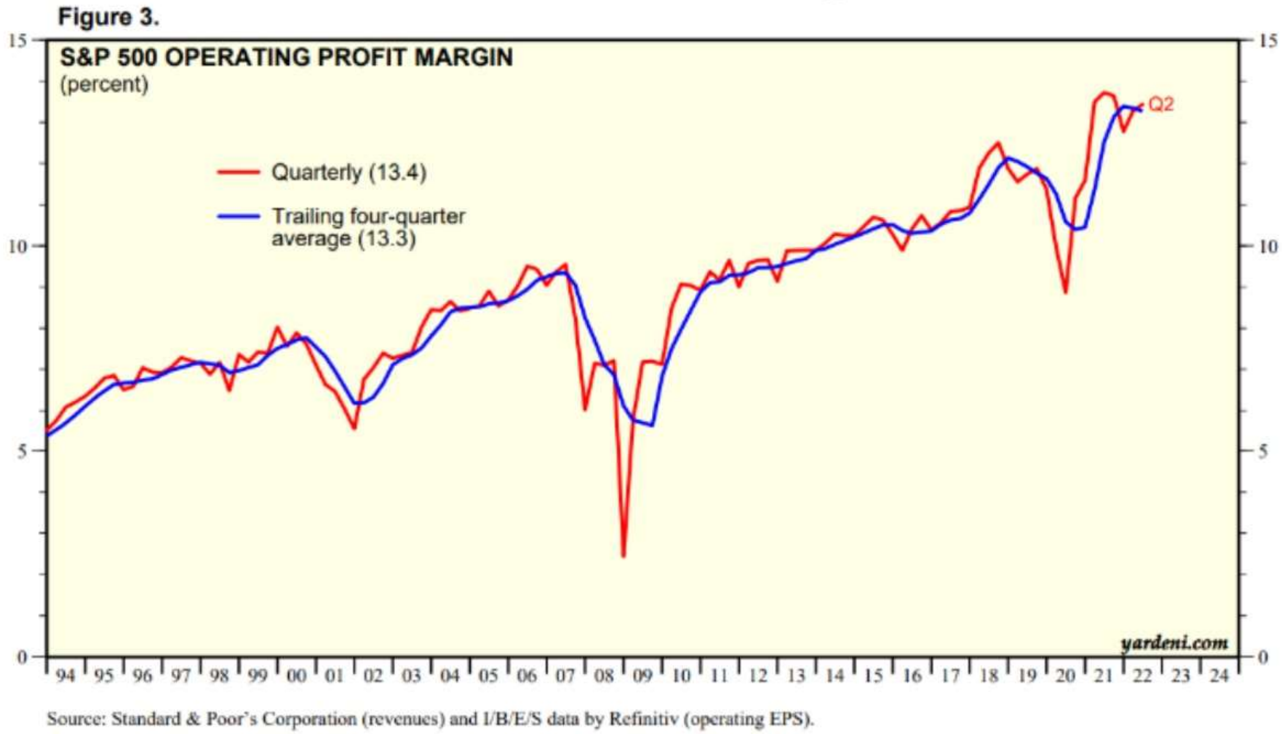




(2) Companies are passing costs through to consumers

At the end of the day higher prices come from businesses raising prices

S&P 500 Profit Margin



How does tightening work?

Inflation UP → Interest rates UP → *A forced contraction of economic activity* → Inflation DOWN

Severity?

Duration?

Recession?

How does tightening reduce inflation?

By slowing the economic machine

Cost of Debt rises

First, higher interest rates raise the cost of debt, which incrementally reduces income.

Asset prices fall

Second, the rise in interest rates, through the present value effect, lowers asset prices, which reduces wealth, which typically raises the savings rate.

Labour market impacted

Third, less spending leads to less demand, and corporates pull back on supply. This leads to higher unemployment.

So what do we need to see?

- **The economic machine needs to slow**

  House prices need to contract, unemployment needs to rise, earnings need to be revised

  Market-wide profit trends did not begin to deteriorate for about a year after the bubble burst early in 2000

- **Inflation optimism needs curbing**

  Markets are now discounting that inflation will quickly fall to desired levels and that this will allow a cut in interest rates in 2023

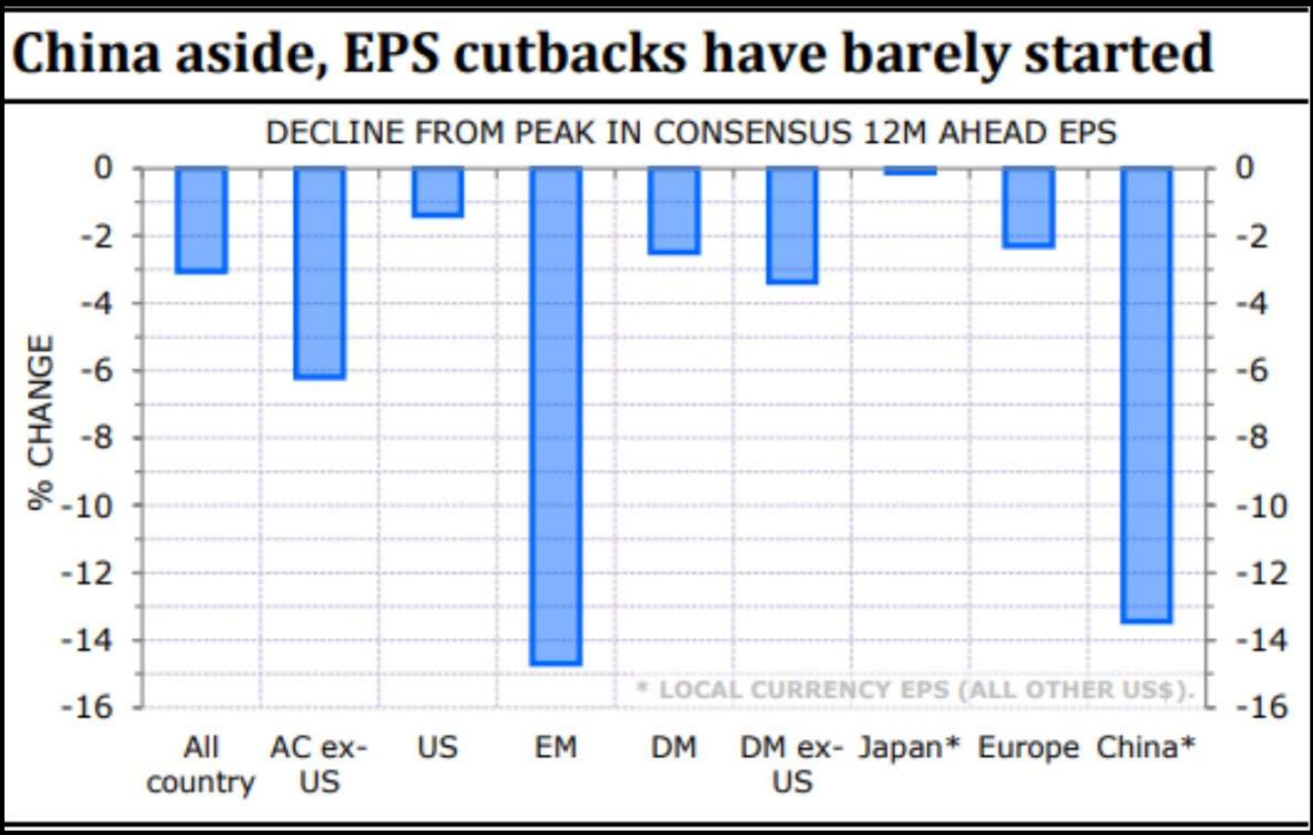
  A near-term economic downturn, an extended period of above-target inflation are not discounted in the markets at all

Asset Allocation

If you adjust recent equity returns for the portion that is attributable *to the rise in discount rates*, they are up.

In other words, *there has been no discounting of a decline in future earnings.*

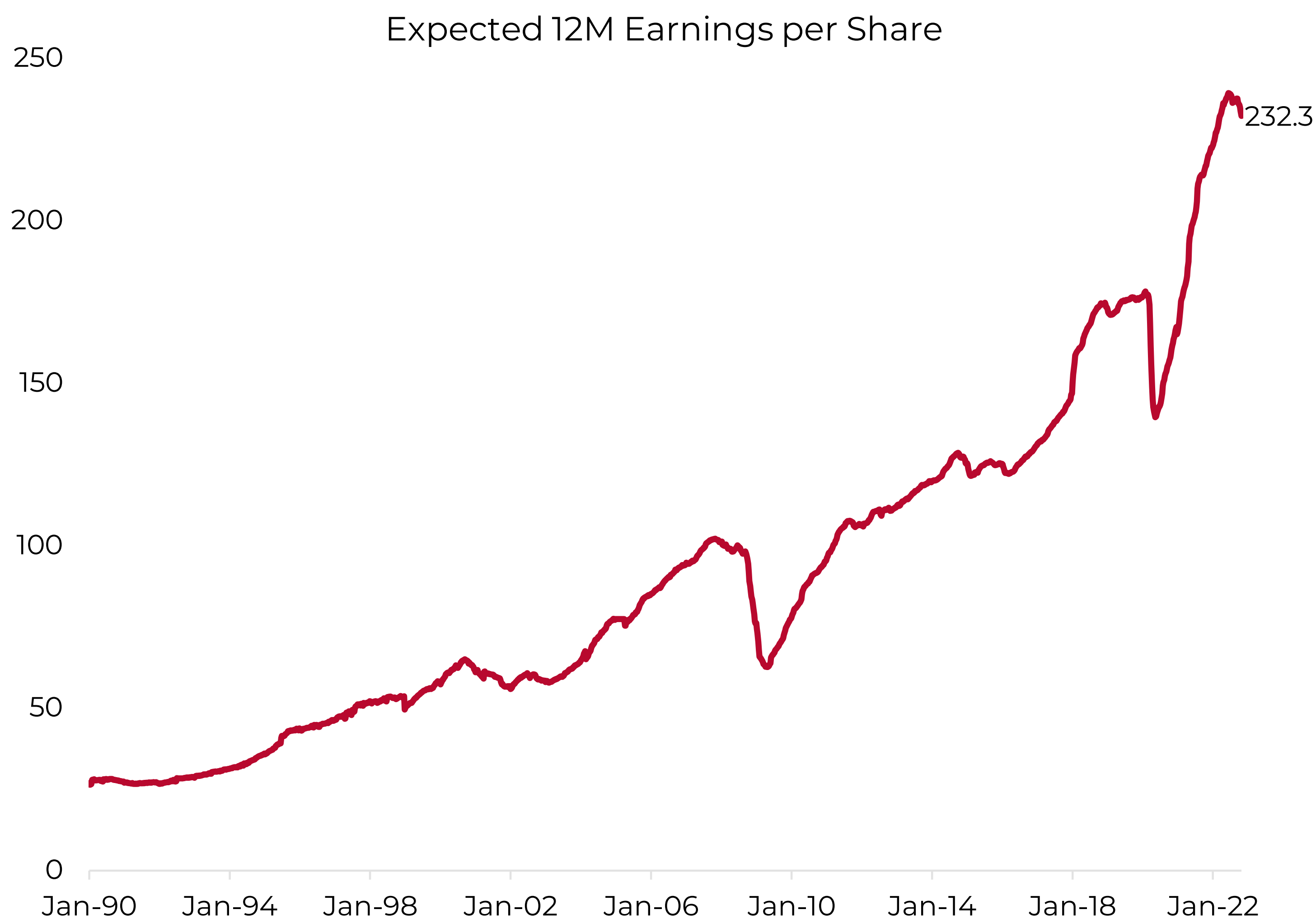
Asset Allocation



The stock market's earning-per-share (EPS) forecasts are some ways from pricing in the likely downside.

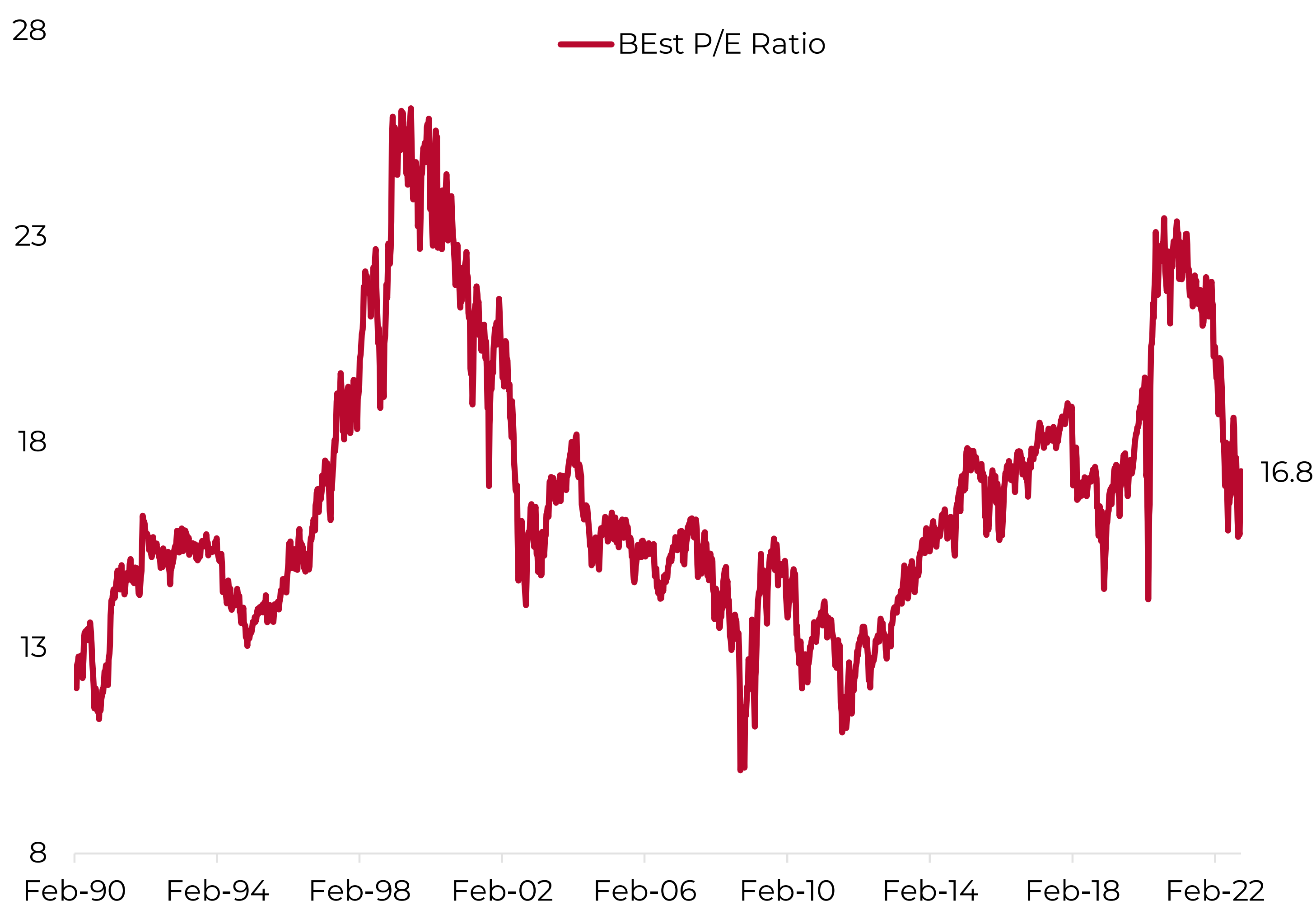
Expected 12 month forward EPS

Standard & Poor 500



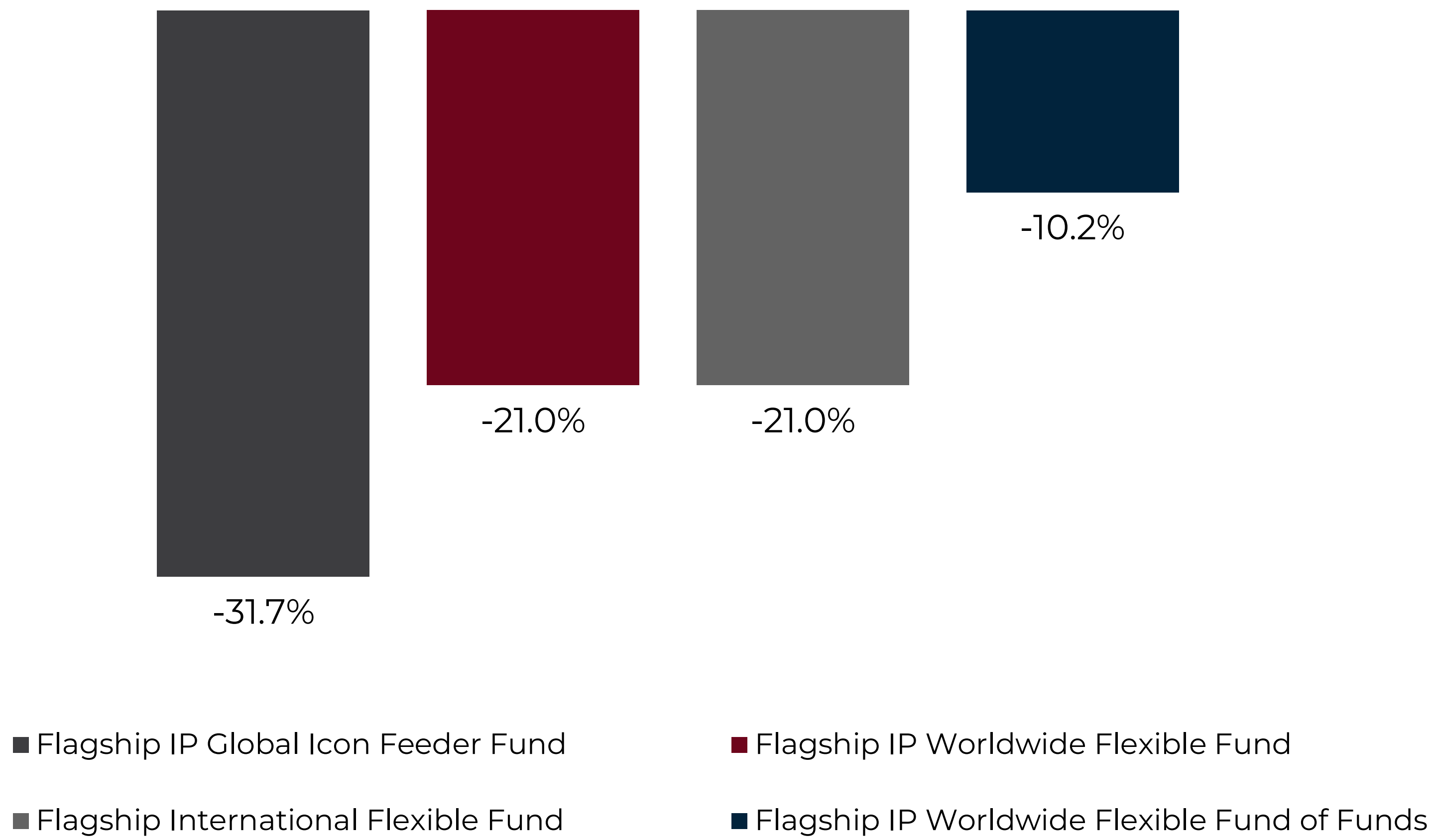
Expected 12 month forward Price Earnings Ratio

Standard & Poor 500



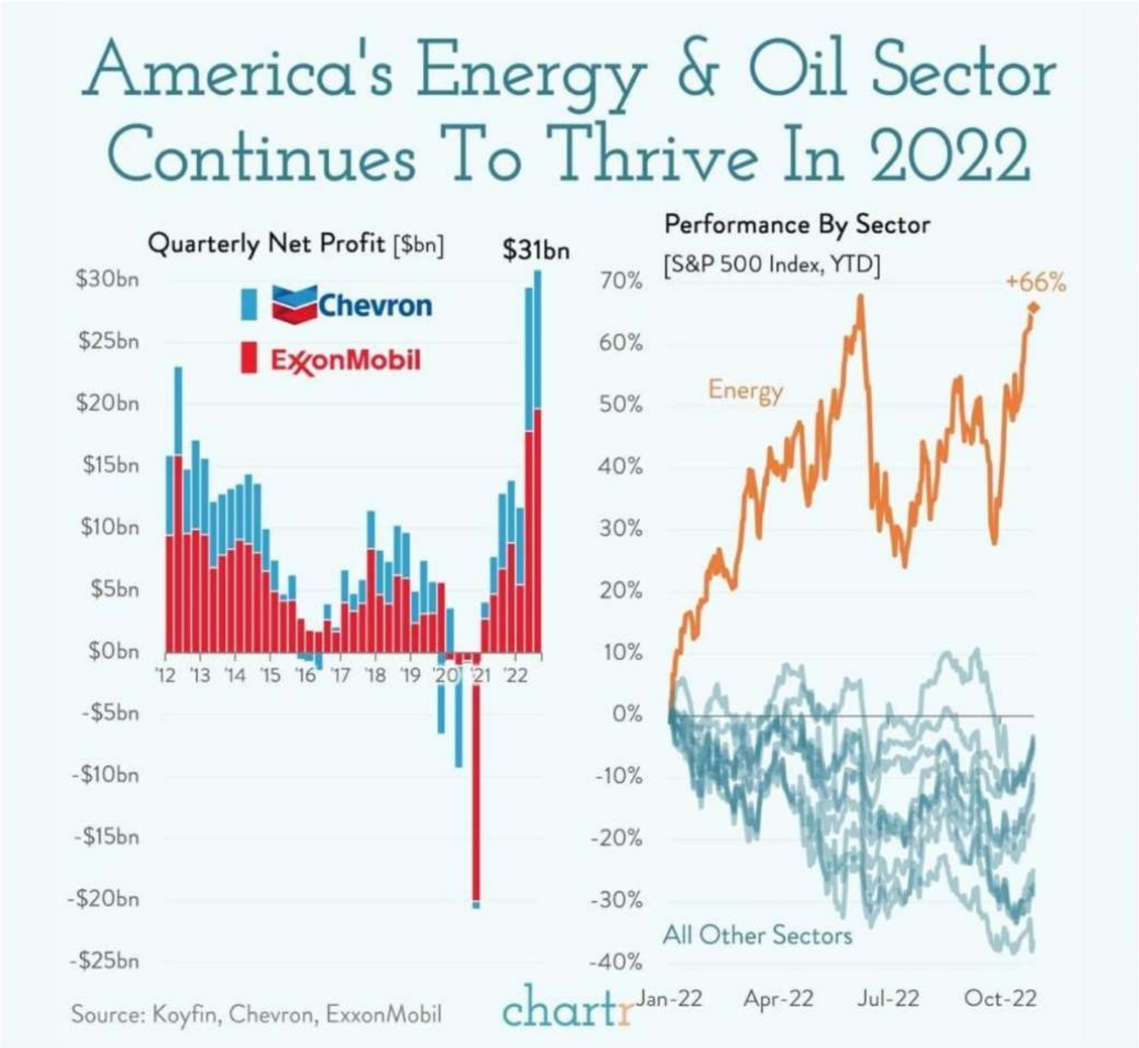
Strategy Performance

YTD (ZAR)



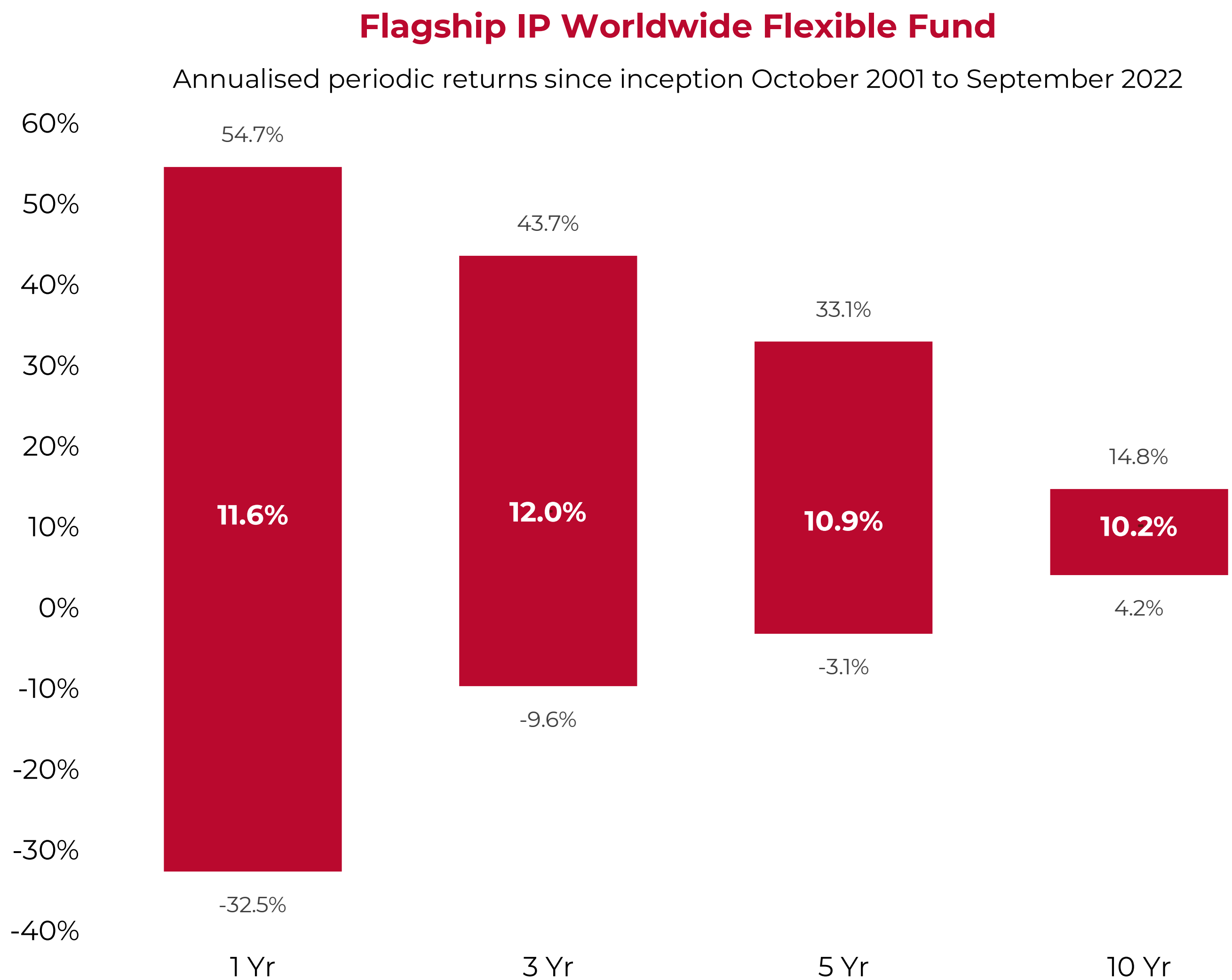
Note: All performance in ZAR to November 1, 2022

One sector heavily skewing the average



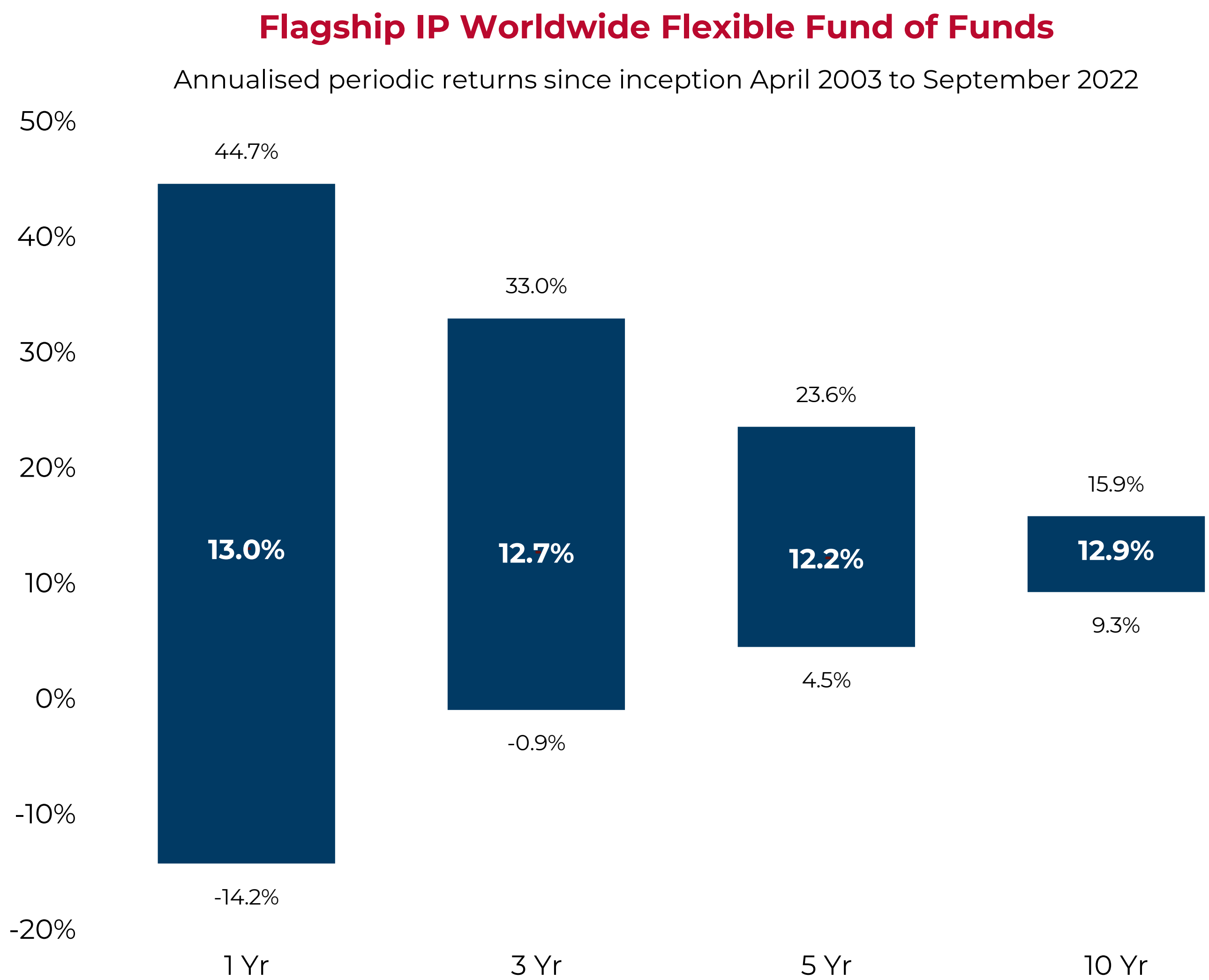
Flagship IP Worldwide Flexible Fund

Annualised periodic returns since inception October 2001 to September 2022



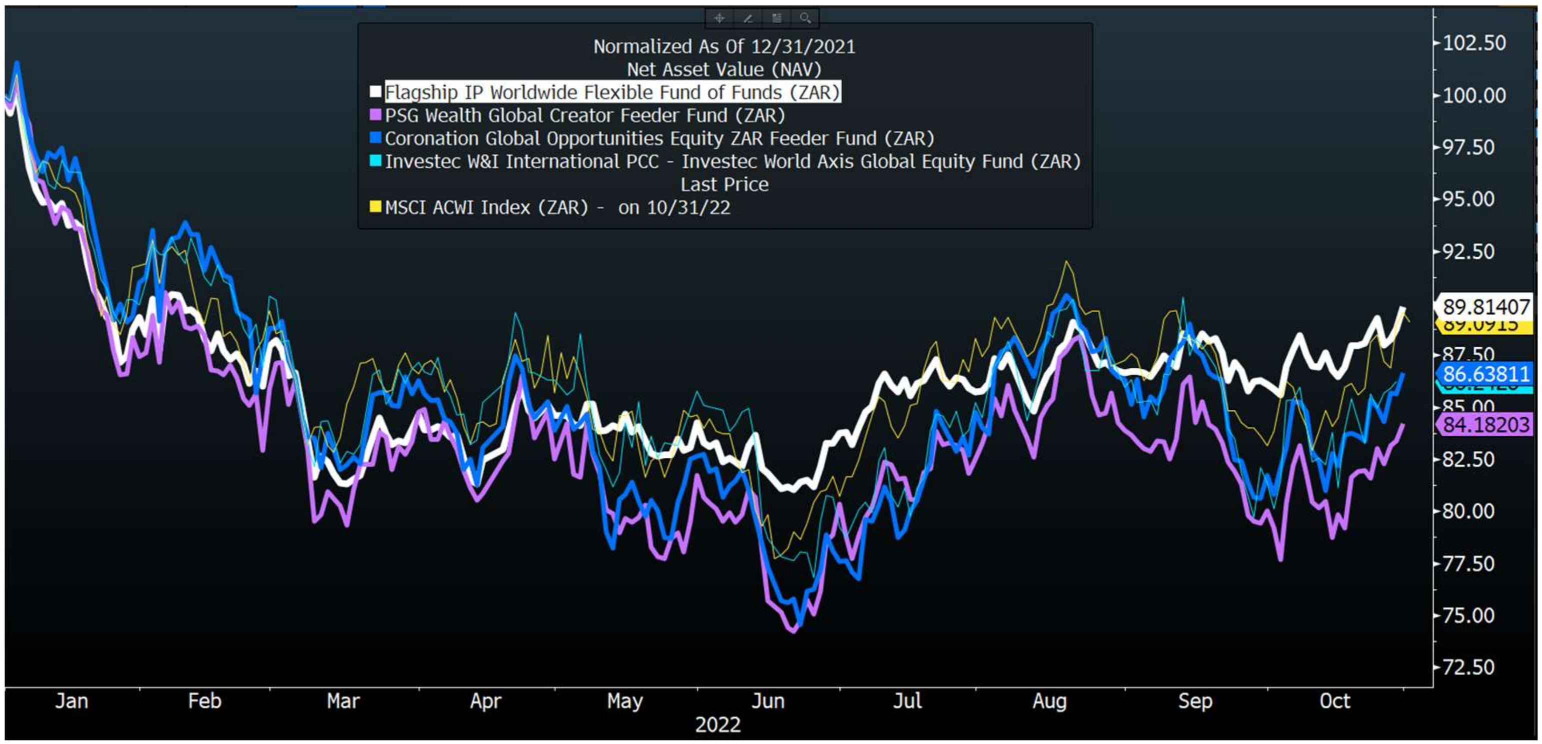
Flagship IP Worldwide Flexible Fund of Funds

Annualised periodic returns since inception April 2003 to September 2022



Flagship IP Worldwide Flexible Fund of Funds

Achieving what we set out to achieve in volatile times



60-65%

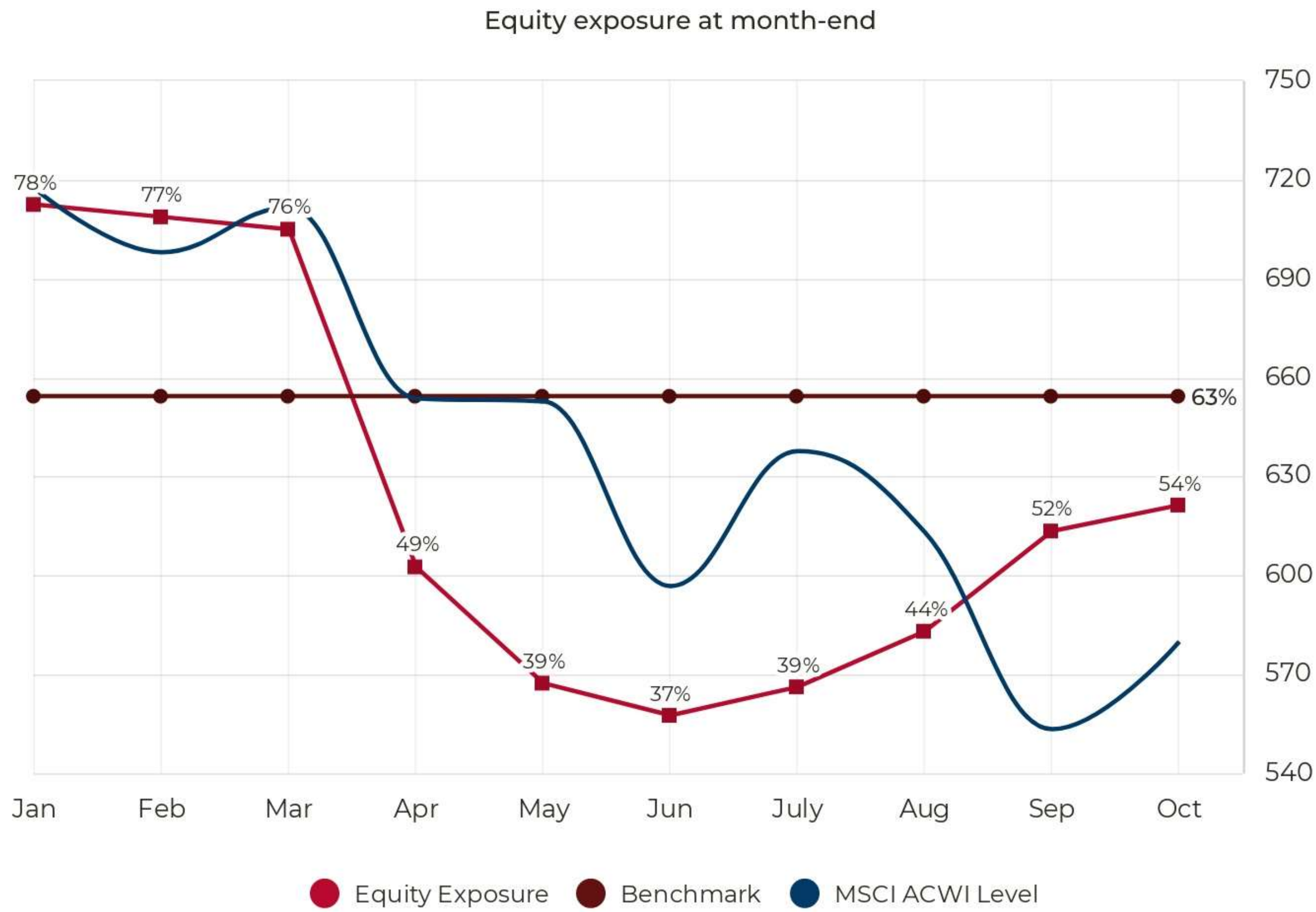
BENCHMARK EQUITY EXPOSURE

53.7%

CURRENT EQUITY EXPOSURE (END OCT 2022)

Market Decline since 1 April

-17.4%



Equity Portfolio changes since January 2022

October 28	Additions Since January	Removals since January
CAPRI HOLDINGS	SCHLUMBERGER LTD	KAROOOOO LTD
APPLIED MATERIALS	SUNCOR ENERGY	HDFC BANK
DICK'S SPORTING GOODS	ISHARES GLOBAL HEALTHCARE ETF	ENDAVA PLC
SCHLUMBERGER LTD	ANHEUSER-BUSCH INBEV	AGESA HAYAT
INFORMA PLC	UNIVERSAL MUSIC	META PLATFORMS
SUNCOR ENERGY	ADOBE INC	JD.COM INC
SQUARE ENIX HD	HYPROP INVESTMENTS	PAYPAL HOLDINGS INC
PAGSEGURO DIGI-A	LEGAL & GENERAL	DUCK CREEK TECHNOLOGIES INC
ANHEUSER-BUSCH I		
UNIVERSAL MUSIC		
MICROSOFT CORP		
ZALANDO SE		
INTL FLVR & FRAG		
TAKE-TWO INTERACTIVE		
AMAZON.COM INC		
ADOBE INC		
ISHARES GLOBAL HEALTHCARE		
HYPROP INVESTMENTS		
RAKUTEN GROUP IN		
ULTRA CLEAN HOLD		
UBISOFT ENTERTAINMENT		
ALIBABA GROUP		
LEGAL & GENERAL		

74%
Overlap to January

Stock example: AMAT

Market perception is incredibly weak

- AMAT is set to benefit from enormous tailwinds for semiconductor capex over the next three years
- Strong balance sheet and even if semis exhibit their traditional cyclicality, these stocks will remain on low earnings multiples
- AMAT's average 5-year ROIC is 28%, and it trades on 11.1x expected earnings

Stock example: Dick's Sporting Goods

Under appreciated niche business

- Gross margins have expanded from 29% pre-COVID to 35% today, and dividends and share buybacks have accelerated
- It’s omnichannel business model has proven resilient through COVID and the recent re-opening
- Dick’s trades on 9.6x 12-month forward earnings and generates returns on invested capital (ROIC) of over 15%.

Stock example: Pagseguro

Unloved payments compounder

- Has increased the number of customers it services as well as its consolidated total payments volume (TPV) by an impressive 58% yoy at latest results.
- While rising interest rates in Brazil have been a headwind for the investment case, we believe interest rates in Brazil have peaked already, and declining interest rates should be a tailwind for earnings going forward.
- PagSeguro trades on 14.0x 12-month forward earnings and generates a ROIC of over 27%.

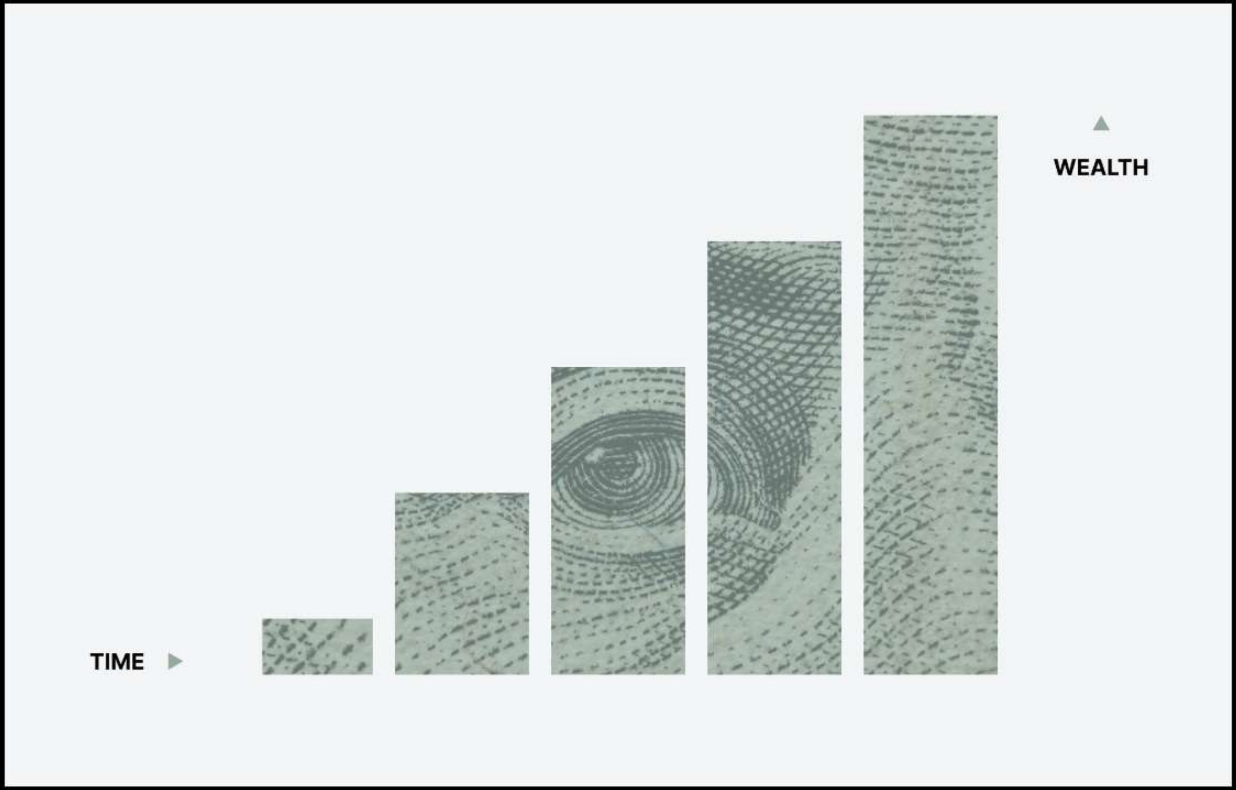
Stock example: UMG

Steady growth at an attractive price

- We see UMG as a way to capitalize on one of the biggest themes over the next 10 years - the proliferation of streaming music across the digital platforms that are increasingly forming part of our daily lives
- The business fundamentals support a multi-year revenue growth algorithm, with the mix effect of higher streaming leading to higher sustainable EBIT margins
- UMG is growing at +10% p.a., generates ROIC's of over 20% and trades on 22x next year's earnings.

This relationship has been tested in the past

And it is being tested today



Concluding thoughts

A lack of FOMO may be our greatest asset right now

- We are cautious in the face of a multitude of potential outcomes in asset markets
- In our equity portfolios we have made a few strategic changes, but the bulk of the portfolio remains the same
- In our flexible funds we remain below benchmark in our exposure to risk weighted assets
- We have ample cash ready to deploy into any continued market weakness