Coronavirus Update

March 2, 2020

Dear Investor,

Many of you are aware of the coronavirus that began in China and has now expanded to other countries around the globe.

The coronavirus disease (COVID-19) was first reported in Wuhan, China, on 31 December 2019. Initially the bulk of cases and fatalities were confined to China, but the virus has since spread internationally. Within the last week there have been newly identified cases in California, Brazil as well as Nigeria. At the time of writing the virus has infected thousands of people globally and more than 3,000 deaths have been recorded.

The situation continues to evolve. For now, it appears that new infections outside China are now outpacing those within the country. Government authorities in infected countries have taken preventative measures, including the closure of schools, and the banning of public gatherings, as well as testing and quarantine of suspected individuals. We expect these measures to continue.

Investors have been unnerved by the steady march of the new coronavirus around the globe, and the growing threat it poses to economic growth. Financial markets around the world fell markedly in the preceding week as economists issued increasingly negative predictions of the extent to which the coronavirus outbreak would impact economies around the world.

Near term effects are certain. For the next few months, holidays, conferences, business meetings and trade shows will be cancelled across the globe. Airlines, airports, hotels and related travel industry participants will be impacted. The oil price, which depends on the demand for fuel, will be negatively impacted. Companies with supply chains dependent on China, such as consumer electronics and IT hardware businesses, will struggle to manufacture products and will lose sales. Consumption at restaurants and shopping malls will fall.

Other effects are less certain, both in extent and duration. At this early stage we are wary of making specific predictions as to the long-term effects of the outbreak.

We remain of the belief that like outbreaks of a similar nature in previous years (SARS and MERS), the virus impact will eventually subside. However, this will not happen until effective quarantining contains the infected population, or vaccine is found, or the virus becomes endemic. Each of these outcomes has a different path and will present different 'tail' risks.

The global economy will move forward again. In the meantime, our job is to ensure that the risks the virus presents should be accounted for appropriately across our Flagship funds, and that investor capital is allocated to the correct assets to protect against the downside.

The effect of the virus on the Flagship IP Worldwide Flexible Fund

The Flagship IP Worldwide Flexible Fund provides long term capital growth by investing in a combination of equity, property, bonds and cash. The fund has the flexibility to change its allocation to each of these assets based on their prospective risks and returns. For 19 years (until the end of January 2020) the Fund has delivered 11.2% per annum, versus its benchmark of 9.2% and inflation of 5.6%, both per annum.

The fund has a growth mandate and, because of this, equities will always constitute the lion's share of the assets. Despite their inherent volatility, equities are, without doubt, the most attractive asset to achieve long term growth. The Fund's allocation to equities will range between 60% (at times of heightened equity valuations when shares are expensive), and 100% (when we believe equities offer excellent long-term value).

The Fund entered 2020 with an allocation of 70% to equities. This level was appropriate given the high valuations of shares (which typically make their prospective returns lower), as well as the rewards and risks that the global economy presented.

Our equity positions, which are spread across 26 high quality companies, have not escaped the fear gripping the market but are well positioned to ride through the uncertainty. We have deep knowledge of these businesses and the resilience of their revenue streams and profits. We are fortunate to have the ability to add to these positions as they fall, allowing us to own more of these great businesses and benefit when they ultimately recover. While we go through this time of uncertainty, we will only selectively be adding to the fund's equity exposure.

The balance of the Fund (the other 30% that isn't invested in equities) is invested in gold, bonds and cash, totalling 30%, or nearly 1/3 of the fund's total assets. These assets have all contributed positively to the performance of the fund, and an appropriate allocation to these safe haven assets will continue as long as uncertainty remains.

We have conducted a thorough review of each company and believe that the position sizing is appropriate for the risk presented. The Fund holds a collection of high-quality companies that have superior business models, low levels of debt, and excellent management. While none are immune to the contagion that the virus may present, these traits will ensure that they survive and, ultimately, flourish. As of this month, the Fund holds:

- Two of the world's greatest online gaming companies: **Netease** and **Square Enix**. Both have iconic consumer franchises in Fantasy Westward Journey and Final Fantasy respectively, with exciting new titles to be released in 2020 and 2021. Both have enviable long-term track records and attract top talent.

- Three of the world's most powerful e-commerce platforms: **Amazon**, **Alibaba** and **Zalando**. While Amazon and Alibaba should be well known, Zalando (the market leader in online apparel sales in Germany) is less well known. These businesses have wide and deep 'moats', powerful cash flow generation and excellent capital allocation standards.

- Three of the world's most iconic consumer staples companies: **Heineken, Mondelez** and **Reckitt Benckiser**. All three companies have world beating products in their brand stables and strong growth prospects.

- Two financial leaders in their space: **Avivasa** and **Quilter**. Avivasa is the largest private insurer in Turkey which is growing its premium revenue north of 20% per year. Quilter will be familiar to most SA investors post its spin out from Old Mutual and is the second largest wealth manager/platform administrator in the UK.

- Two leading Media companies **Walt Disney** and **Facebook**. Walt Disney is the owner of some of the world's most valuable entertainment content, and has recently taken control of its distribution. Facebook remains the most powerful media advertising business in the world, with opportunities across its Facebook, Instagram and WhatsApp platforms.

- Two world class industrials, **Ferguson** and **DS Smith**. Ferguson is a supplier of plumbing and building materials to wholesale and retail clients, and is a leader in its space. DS Smith is the most innovative packaging company in Europe that has recently entered the US and growing quickly there as well.

- Two undervalued tech giants **Alphabet** and **Microsoft** and one emerging tech player called **Xero**. Alphabet owns Google, the largest search engine outside China, while Microsoft is best known for Windows, its Office suite of products (Word, Excel, etc) and its cloud business Azure which is the second largest after Amazon Web Services. Xero is one of the pioneers in cloud-based accounting software.

The effect of the virus on the Flagship IP Worldwide Flexible Fund of Funds

The Flagship IP Worldwide Flexible Fund of Funds provides investors with global equity exposure through a curated selection of experienced global equity managers. Its mandate is to beat inflation +5% through the cycle, something it has been able to achieve since inception (April 2003). For 17 years (until the end of January 2020) the Fund has delivered 13.8% per annum, versus its benchmark of 10.5% and inflation of 5.1%, both per annum.

The Fund of Funds is 73% invested in equities at the time of writing. The rationale for this level of equity exposure is the same as the Flagship IP Worldwide Flexible Fund, being our views on equity valuations and prospective risks and returns.

The equity positions held by our managers have robust investment cases. The Fund also enjoys diversity on geographic and sectoral level. These positions (as in the Flagship IP Worldwide Flexible Fund) are unlikely to avoid being affected but are also well placed to ride through the uncertainty.

The balance of the Fund (the other 27% that isn't invested in equities) is currently in cash. The portfolio managers plan to deploy this selectively, as and when the opportunity presents itself.

Summary

The Flagship global investment team focusses on allocating investors' capital to the highest return assets in our mandated universe, without taking undue risk. This has been achieved over 19 years, including periods with heightened market volatility.

The current uncertain environment allows us to deploy this strategy to protect your investments and to position the Funds for growth in the future. Risk management is not only a consideration during times of stress. It is embedded in the way we build portfolios every day, and is at the forefront of our decision making. We remain diligently focused on the macroenvironment and your investments, and stand ready to respond to any further developments.

Please contact the team at Flagship if you have queries regarding your investment in Flagship, your portfolio's holdings, or if you would like to speak to one of the portfolio managers. Our door is open. We thank you for your continued support.

Regards,

Pieter, Kyle and Winston

  

Established in 2001, Flagship is an independent asset manager, owned entirely by staff and directors. We are a specialist global equity manager and we run three distinct global strategies: Equity, Flexible and Fund of Funds. We follow a robust, common sense approach to investment management founded on fundamental principles. We believe that long-term, focused, valuation-based management is the best way to manage our investors capital.