TRANSACTION RATIONALES

Purchases

Chubb – Add to our position on growing comfort regarding our investment case thesis

5-year chart: Chubb vs. the Bloomberg World Index and the Sector

Source: Bloomberg | Data range 14.08.2018 – 14.08.2023
Total return in USD | Note: past performance is not a reliable indicator of future results

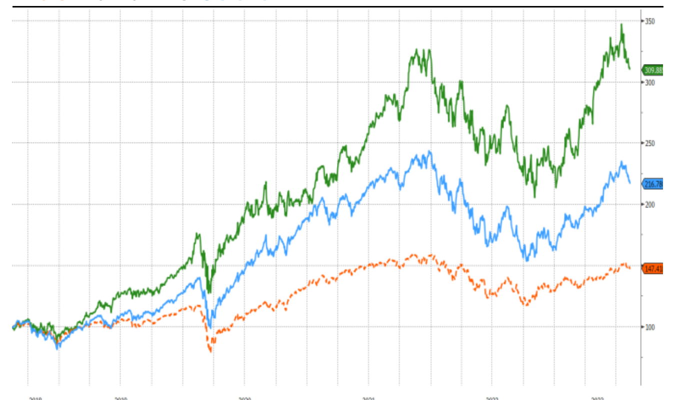
Since we have initiated the position, Chubb has announced a 5bn$ repurchase program (6.5% its MC) and has released earnings that demonstrate the solidity of its insurance franchise as well as outlined broad & durable improvement in the underwriting conditions across its market.

All those positive developments reinforce our confidence in the compounding power of that high-quality insurance franchise, as well as of the discipline and the strategic vision displayed by its management. In addition, the ongoing rise in interest rates supports the gradual increase of the yield received on its insurance float, which in essence means that Chubb is a net beneficiary of rising interest rates. While our investment case predicated on competitive advantage of the company's underwriting, cost management and quality of management, the interest income part adds a welcome further tailwind.

Given all the positive developments mentioned above and looking at the quality and stability of the business, Chubb offers excellent value-for-money with limited risks. Therefore, we further increase our positions in the Focused Equity Strategy.

Microsoft – add to one this software and cloud franchise with one of the most entrenched competitive position

5-year chart: Microsoft vs. the Bloomberg World Index and the Sector



Source: Bloomberg | Data range 14.08.2018 – 14.08.2023
Total return in USD | Note: past performance is not a reliable indicator of future results

Microsoft is the gold standard of Software stocks with the widest and deepest competitive moats of any IT-company as it offers a broad portfolio of strategic products such as cloud computing, collaboration software (Office and Teams) and now Artificial Intelligence (AI). While AI is still in the early innings and profitable use cases for the technology remain few, Microsoft is one of the obvious beneficiaries who will be able to generate tangible profits from the new technology fast by making their products more efficient (and hence more valuable) for its users through AI and then charging more for their use. Their first indications of additional AI-related revenues generated from AI in their cloud-business support that view.

Even though we have not yet baked in any additional revenues or profits from the AI-opportunity, the stock's recent correction from $363 to below $320 offers a good opportunity to add to this high-quality and steady grower at a decent discount to fair value again. Therefore, we add to our positions in the Focused Equity Strategy.

Sales

Alibaba: Prisoner of a structurally deteriorating operating and political environment

We are selling the remaining positions in Alibaba as the shadow banking system and the real estate markets seems to be slipping ever deeper into crisis and the political and long-term economic outlook for China looks bleak.

Alibaba's shares remain cheaply valued and recent quarterly results were decent, but the combination of lackluster e-commerce industry growth and cautious political and long-term economic outlook leaves little to hope for mid-to long-term.

Considering the uncertain political and economic outlook in combination with facing a fiercely competitive e-commerce industry, we prefer to invest in investment cases that are clearer, and less dependent on the aforementioned macro- and political considerations.

5-year chart: Alibaba vs. the Bloomberg World Index and the Sector

Source: Bloomberg
Total return in USD
Data range 14.08.2018 – 14.08.2023
Note: past performance is not a reliable indicator of future results

Henkel: Lower volume pointing to slow franchise turnaround

While earnings came in slightly ahead of expectations, product volumes fell faster than expected, indicating weak pricing power and a weak market position. Even though the company owns some world-class businesses, their problem zones (US-consumer business, brand value and recognition) have not been tackled with the necessary focus and resolve for too long, in our view.

5-year chart: Henkel vs. the Bloomberg World Index and the Sector

Source: Bloomberg
Total return in USD
Data range 14.08.2018 – 14.08.2023
Note: past performance is not a reliable indicator of future results

This latest earnings report cements that view. According to UBS-Research, Henkel generated the worst-in-class volume growth in Q2 for Consumer Brands (-10.9%, lowest 4-year CAGR among Food & HPC large caps) leading to an impression that the company continues to overly emphasize rapid margin recovery over brand value and market share gains. This is illustrated by Henkel's intention to pass additional price actions in H2.

While the US-consumer business has been a drag for years, the increasingly poor performance of their European business leaves us particularly concerned. UBS also noted that, based on NielsenIQ, Henkel has been consistently losing market share across its key categories in Western Europe. Henkel has been leading on pricing growth (+15% YTD vs sales weighted category average of +9%) but has been consistently underperforming on volume (-18% YTD vs category avg of -1%).

While valuation looks low at first sight, but because of the challenging market environment ahead, the one-sided focus on pricing and the ongoing lack of action on strategic issues by management, we don't see a clear road to a turnaround anytime soon. Therefore, we have decided to sell the position

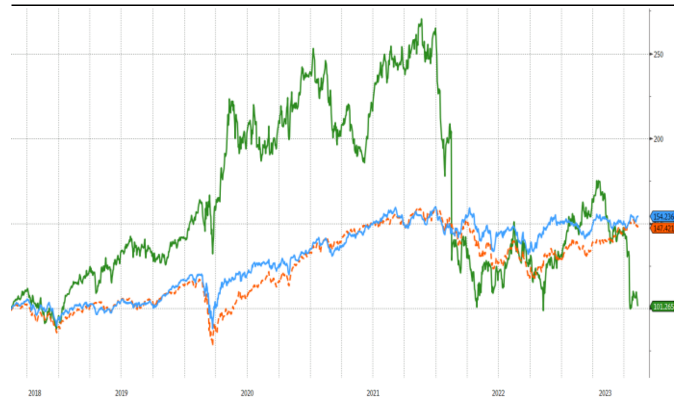
in our Focused Equity Strategy and we re-invest the sales proceeds in some of our highest conviction investment cases at offer significant discounts to their fair value instead.

Masimo: Strategic vision and capital allocation is no longer clear

After issuing a profit warning and guidance cut in July, Management held their quarterly earnings call on August 8. After having significantly revised down revenue guidance for the core health care business (by -10%) as well as for the newly acquired consumer business in July, management offered little additional insights at the call.

Instead, they made a lot of effort at said call to explain that the sensor sales drop in their core hospital equipment business was transient (high inventories leading to destocking, lower hospital inpatient census, premature end to flu season) and that in general the fundamentals of that business remained strong (Unrecognized Contract revenue still growing low double digit).

5-year chart: Masimo vs. the Bloomberg World Index and the Sector



Source: Bloomberg — Data range 14.08.2018 – 14.08.2023
Total return in USD — Note: past performance is not a reliable indicator of future results

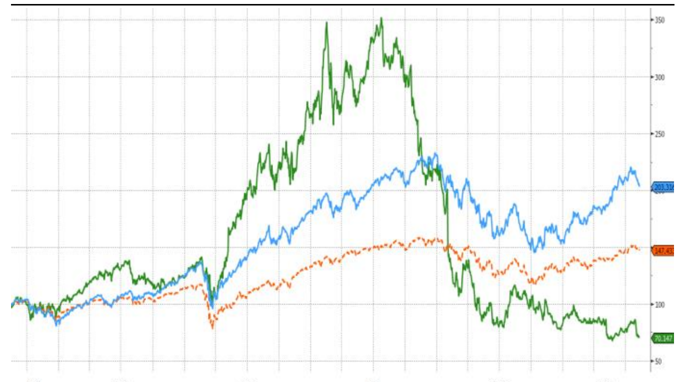
While the core hospital equipment business maintains a strong competitive position, the mid-term the outlook remains blurry as the future level of sensor consumption after the covid-related disruptions is not entirely clear and management wasn't able to offer any firm indication. What's more, while the new consumer-health products (W1-watch, Storck baby-monitoring device) are now being launched, the initial uptake looks fairly slow, particularly for the W1-watch. As a result, the sales targets for 2023 & 2024 that the company offered were at the low end of our expectations. Even though we think that both products have good long-term potential, uncertainties remain, and they won't make a significant contribution to profits anytime soon. Also, the newly acquired consumer business suffered a demand setback that didn't come as a complete surprise when looking trends in the industry, but the magnitude was unexpected.

While surely some of the special factors management mentioned for the shortfall were at work, we are stunned that management seems to have been so blind-sided by so many issues at the same time, raising questions if they have enough control of their businesses. Worse, we came away from the analyst call with the impression that management doesn't seem to have a clear plan on how to deal with the multitude of challenges they are facing. But not only that. Again, the communication of management around a major corporate news event was poor and investors and the analyst community were disappointed. That comes on top of a disappointing meeting with company representatives that we had at their head office in Irvine, California, in June.

The stock has recovered some 8% from the lows after the July announcement, but, given the lack of a clear action plan from management and our significant doubts about the way forward raise serious questions about the base assumptions of the investment case. Therefore, we sell the position.

Paypal: deteriorating competitive position and structural pressure on profitability

5-year chart: Paypal vs. the Bloomberg World Index and the Sector



Source: Bloomberg
Total return in USD
Data range 14.08.2018 – 14.08.2023
Note: past performance is not a reliable indicator of future results

PYPL posted results above Street estimates on both the top and bottom line. While all this is encouraging, the mix shift to lower margin unbranded revenue is limiting the impacts from the cost initiatives and share buy backs. The unbranded business not only has a narrower competitive moat, if any, but net take rates are lower, in some cases substantially, which in turn limits transaction gross profit growth significantly, which is the most important measure. Adjusted for one-off items transaction gross profit grew just 1% yoy in Q2.

While we like the stronger focus on operational efficiency and cost management, the growing share of lower-margin unbranded revenue continues to weigh on transaction margins, offsetting a significant amount of the positive benefits from SG&A leverage. What's more, the payments industry is currently going through a period of disruption as new players appear on the scene and new payment channels gain traction. We have particular concerns regarding PayPal's core business focused on Small and Midsized business (SMB), where various new competitors such as Block have emerged and are entering Paypal's turf from below, while the company has been focusing lately on pushing their business with large merchants such as Booking.com, a business with is lower margins.

While valuation looks cheap at first sight, the multiple areas of concern and the risk of being disrupted in the core SMB-business won't allow for any re-rating anytime soon. The still ongoing search for a new CEO adds to the discomfort. Given our desire to focus on the strongest investment cases, we sell the small positions in our style neutral strategies.

With kind regards,

Emerald Wealth Partners AG, Investment Office

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