Portfolio performance

The Swell Global Portfolio advanced 31.4% after management fees in the 12 months to December 2019. Over the same period the All Ordinaries Index and MSCI World Index returned 24.06% and 27.86% respectively.

In the six months to 31 December 2019 our benchmark index, the MSCI World Global Index rose 8.95% while the ASX All Ordinaries rose 3.59%. Pleasingly, the Swell Global Portfolio outperformed both indices rising 9.74% over this period.

We were pleased with the performance of the Swell Global Portfolio in calendar year 2019. The result can be attributed to our investment philosophy which values a long term orientation together with rigorous independent proprietary analysis. Investment returns cannot be considered in isolation, they must be weighed relative to comparative opportunities.

With our long term focus we believe the most appropriate comparison for the Portfolio is to the US 10 year government bond rate, also known as the risk free rate and yielding 1.92% at December 31 2019. As long as it remains at these levels, equities are attractive.

Market conditions

Global equity markets rallied in the second quarter of FY2020 as expectation around a phase 1 trade deal between the US and China bolstered investor sentiment. At the same time, sovereign yields rose, and global investment grade credit spreads tightened with many central banks maintaining an easing bias.

Our investment philosophy requires us to focus our attention on the acquisition of businesses capable of delivering higher revenue and earnings over the long term. While the direction of the economy is important it does not instruct our investment decisions.

Portfolio Investments

Our top three investments in the half were Apple, Alphabet and Microsoft. We discuss each company below.

Apple

Apple reported a strong 4Q19 beating consensus revenue and EPS estimates. Revenue grew 2% to $64 billion driven by a record quarter for services which were up 18% to $12.5 billion. EPS came in at $3.05 up 4% on 4Q18 and 7% above consensus. Apple returned over $21 billion to shareholders over the quarter including $18 billion in share repurchases and $3.5 billion in dividends as it maintains its target of reaching a net cash neutral position over time.

Other notable achievements included:

- Apple increased orders of its latest AirPods Pro at a number of its Chinese and Vietnamese manufacturers to keep up with surging demand. Wearables such as AirPods and Apple watches are an increasingly important part of the iPhone makers revenue and over the past three years quarterly revenue from wearables has almost tripled from $2.3 to $6.5 billion, with the segment now contributing more than 10% to total revenue.
- Apple unveiled a new 16-inch Macbook Pro calling it the world's best pro notebook. It features Apple's largest ever retina display with a ninth generation 8 core processor and up to 64GB of memory. It can be configured to hold up to 8TB of storage. Apple says the device is designed to be used by a range of professionals including developers, scientists, photographers and filmmakers.
- Apple released three new iPhones along with a range of other devices. The iPhone 11 and 11 Pro feature incremental changes on last year's devices including a new ultra-wide-angle lens. The Apple Watch also received an upgrade with the new 7th generation device featuring an always on display. Apple also introduced its TV subscription (TV+) and Game Streaming (Arcade) services to be rolled out to over 100 countries.

Alphabet

Alphabet reported its 3Q20 earnings, beating consensus revenue. Gross revenue for the quarter was $40.5 billion, an increase of 20% over the same quarter last year. Operating income of $9.2 billion was in line with our expectations and reflects increased spending on new hires during the quarter.

Larry Page stepped down as CEO of Alphabet, appointing Sundar Pichai as CEO of Alphabet in addition to his CEO position at Google. Mr Page and his co-founder Sergey Brin will continue their board roles and will remain active in planning the company's future. In a letter to Alphabet's employees in December the founders said: "Today, in 2019, if the company was a person, it would be a young adult of 21 and it would be time to leave the roost. While it has been a tremendous privilege to be deeply involved in the day-to-day management of the company for so long, we believe it's time to assume the role of proud parents— offering advice and love, but not daily nagging!" Mr Pichai joined Google in 2004 and has been Google CEO since 2015 when Alphabet was established.

Other notable achievements included:

- Google will offer cheque accounts to consumers as it moves into the banking space in 2020, partnering with Citigroup and Stanford University in an effort to hasten regulatory and compliance requirements. Citigroup does not have as large a brick and mortar presence as its peers Wells Fargo and Bank of America and the partnership seeks to overcome this disadvantage by creating a broader digital presence.
- Google announced the game titles available on Stadia, its cloud gaming platform which has launched in more than 10 countries. 12 titles including classic names such as Assassin's Creed, Mortal Kombat and Tomb Raider with several more games due to release in the coming year. A free version is available where users can stream games that they purchase individually although most users are expected to take up the subscription option.
- Alphabet's Loon signed a commercial agreement with Spanish telecommunications company Telefonica to bring internet to remote parts of the Amazon. Loon will commence operations in 2020 servicing a portion of the Loreto region in Peru with a population of around 200,000 people. It's not the first time the two have worked together, having partnered in May 2019 to bring emergency internet to Peru following a magnitude 8 earthquake. Loon, one of Alphabet's 'Other Bets', provides mobile internet coverage to remote areas via autonomous high-altitude balloons.

Microsoft

Microsoft released its first quarter FY20 earnings beating consensus revenue and EPS forecasts. Total revenue for the quarter increased 14% to $33.1 billion while EPS grew 21% to $1.38. All operating segments came in above management's guidance driven by particularly strong growth in Office commercial, LinkedIn, Dynamics 365 and Azure. The company also announced it returned $7.9 billion to shareholders in the quarter through share repurchases and dividends, a 28% increase from the first quarter last year.

Other notable achievements included:

- Microsoft advanced several initiatives during the half including its Azure Quantum computing cloud service and its partnership with AT&T to provide 5G cloud services. The Teams app achieved 20 million daily active users, a 50% increase over the number in July 2019.
- In October the company revealed two partnerships in the medical sphere. The first with pharmaceutical company Novartis will use AI in the R&D process to discover and manufacture new medical treatments. The collaboration will focus on personalised treatments for macular degeneration, manufacturing of gene and cell therapies and improving the speed and cost of bringing new drugs to market. The second with Nuance Communications aims to build the medical examination room of the future. The partnership will focus on creating what the duo are calling "ambient clinical intelligence" allowing doctors to focus on the patient rather than entering data into a computer.
- Major commercial contracts announced in the half included the US defence department's JEDI cloud contract worth $10 billion over 10 years and the integration of Salesforce's Marketing Cloud on the Azure platform.

2020 Outlook

Financial markets in 2020 will respond to unpredictable financial, political and social issues. Our portfolio investments will be influenced to a greater extent by their unique business drivers and less by the direction of the broader economy. An exclusive focus on the economy does a huge disservice to the opportunities for each company.

While we cannot provide any insight about the return on the broader market in the years ahead, we ensure we will continue to focus on the acquisition of high quality global businesses at discounts to their intrinsic value, conservatively stated.