Portfolio performance

The Swell Global Portfolio increased by 7.25% in the six months to December 31 2020, lagging the MSCI world index by 2.49%. Volatility on global share markets caused by the worsening pandemic leading into the northern hemisphere winter saw a number of our stocks fall.

We used the volatility to increase our holding in some stocks as prices dipped, reducing our cash balance to 9.6% at the end of the half, from 17.0% on June 30.

Market conditions

The global pandemic has created unprecedented disruption and continues to generate uncertainty for investors. Governments around the world have enacted significant fiscal and monetary stimulus which is, for now, providing a bridge over troubled water.

Interest rates globally continue to be pressured creating a rotation out of long term bonds into higher yielding investments like equities. Earlier this year, as the impact of COVID was assimilated into equity prices, high quality companies with strong outlooks were highly coveted leading to a rise in their share prices relative to lower quality companies.

As confidence in the recovery grew, investors rotated out of high quality companies into cheaper lower quality companies with more short term upside. The trend also impacted smaller technology companies, leading to a raft of initial public offerings as private companies sought to capitalise on market enthusiasm.

Most recently, Airbnb tapped the market, with its share price increasing more than 100% on its first day of trading. While we like the long-term outlook for Airbnb, we worry about the current price and the strain it places on investment returns over time. Similarly, Tesla's value rose so dramatically towards the end of the year that by early January the company was worth more than the combined value of all the major automotive brands. It is not hard to imagine the traditional manufacturers achieving parity with Tesla's product in the medium term.

As we have said previously, 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 short to medium term direction of the economy is important, it does not instruct our investment decisions.

Portfolio Investments

We sold our holdings in Nestle and Visa in July. We acquired Nestle in 2017, and were optimistic about the company's divestment of non-core assets and improved profitability across its stable of brands. However we believe increasing competition from supermarket private label brands will require companies in the consumer packaged goods sector to invest heavily in marketing to expand market share.

While we have confidence in Nestle's strategy of premiumisation, we acknowledge it is stepping out the risk curve at a time when value brands are gaining deeper consumer acceptance. The share price has rallied significantly since 2017 and we believe much of its expected value has now been realised.

We sold Visa based on our estimates of its intrinsic value and current market price, preferring Mastercard as a long term investment due to its more innovative and technology driven business model.

In August we sold S&P based on our estimate of its intrinsic value and current market price and used some of the proceeds to increase our holding in Deere & Co.

We added The Walt Disney Company to the Portfolio in September, having seen its share price fall due to the closure of its parks and cruise lines and the cessation of big budget theatrical movie releases. Disney's core value and competitive advantage lies in its intellectual property.

We believe it will maintain its competitive advantage by continuing to invest in its established assets. As the cable delivered home entertainment model is superseded by streaming services globally, Disney is well placed to increase value in its Direct-to-Consumer model which will generate value through increased revenues, higher margins and more focussed customer relationships.

Our top three investments in the half were Deere & Co, Starbucks and Alphabet. We discuss each company below.

Deere & Co

Deere, like most global companies, saw sales decline over the year ended November 1 2020, however through disciplined cost management and execution of its corporate strategy, fourth quarter net income rose 5% from Q419. Management raised its guidance for 2021 earnings to $3.6 to $4.0 billion, based on improving fundamentals in the agricultural sector which is predicted to drive stronger demand. The company's strategic emphasis on precision agriculture has accelerated in recent years, with more than $1 billion spent annually on R&D over the last ten years.

In September Deere finalised its purchase of Unimil, a leading Brazilian aftermarket parts business which services the country's sugarcane growers. The deal fits well into Deere's pivot into the aftermarket parts and service business, as well as demonstrating the importance of the region to its global sales. In November Deere acquired farm profitability software company Harvest Profit to add to its stable of decision making technology to improve farm productivity. The software provides forecasting insights based on field-by field data on costs and profit tracking.

Luke Chandler from Inverell in NSW was appointed Managing Director for Deere's Australia and New Zealand operations in November 2020. He told Bloomberg that although the company was already a market leader in the ag and turf industry in the region, it saw significant opportunities to grow its precision agriculture and construction businesses. Last year Deere reported revenue from the region, which includes Asia, Africa and the Middle East, of $3.8 billion, equating to roughly 10% of total revenue.

Starbucks

At the investor day in December 2020 Starbucks CEO Kevin Johnson said the company expects EPS growth of more than 20% in FY22, and 10% to 12% growth in FY23 and FY24. The Growth at Scale agenda that has been guiding Starbucks operations since 2018 has focussed on accelerating growth in Starbucks' two biggest markets, USA and China, as well as expanding its global reach, particularly through the alliance with Nestle. The company quickly adapted to changes in consumer behaviour as a result of the pandemic and government-imposed restrictions, accelerating development of its digital customer communications as well as changing the design of stores to include pickup options and contact free customer interactions. A new app created late in 2020 enables users to send Starbucks eGift cards to friends and colleagues through Microsoft's Teams chat function.

New stores in South-east Asia extended Starbucks global reach, and the Tata Starbucks joint venture in India opened a number of new stores and announced education and vocational programs to support girls and young women to finish school and develop entrepreneurial skills.

In December the company announced Mellody Hobson will become non-executive chair in March 2021, when current chair Myron Ullman retires. Ms Hobson has been on the Starbucks board since 2005 and has served as vice chair since 2018. She is co-CEO of Ariel Investments LLC and a director of JP Morgan Chase.

Alphabet

Alphabet's third quarter results, released in late October, beat markets expectations for both revenue and EPS. Net revenue excluding traffic acquisition costs was $38 billion, outpacing consensus expectations of $35.3 billion, while EPS of $16.40 came in 43% above consensus. The result reflected the recovery in ad spending for both search and YouTube as well as continued growth in Google Cloud and Google Play Store revenues. On the call management said while the result was strong there are still some uncertainties in the external environment and the company will continue the relentless pace of investments in cloud even in the face of potentially slowing ad revenue growth

In July subsidiary Loon launched a commercial internet service in Kenya using its high altitude balloons to provide cellular services via Telkom Kenya. The service will cover roughly 50,000 square kilometres. It launched a $10 billion fund in India to accelerate the country's digital economy, furthering a relationship with the country which began in 2004.

Google updated its Play Pass subscription based game and app store, adding new titles and streamlining subscription pricing. G-Suite introduced a new integrated workspace for users to intelligently combine contacts, content, tasks and tools to be able to move between functions and collaborate more effectively. G-Suite was rebranded to Google Workspace in October. A four year agreement with Uber for its drivers to use Google's Maps platform will further accelerate the monetisation of maps data.

Pixel 5G phones launched in October, incorporating Google's latest camera technology and extended battery life. In November Google launched a new version of its Google Pay app with dramatically expanded features and capabilities beyond the traditional tap-to-pay service. It now includes full banking services, budget management and peer-to-peer lending capabilities, as well as customised deals and discounts. The app allows users to link Google Photos to scan receipts and Gmail to search for bills and subscriptions.

The new "Plex" cheque and savings accounts will have no monthly fees, overdraft charges or minimum balance requirements.

The company has teamed with Citibank to roll out many of the new services but signalled potential partner agreements with 11 other financial institutions in 2021. Google's acquisition of Fitbit was approved by the EU in mid December, providing a platform for Google to join the growing wearables and fitness trends sweeping the world.

2021 Outlook

Despite the rapid roll-out of a number of vaccines at the end of 2020, the global pandemic will very likely maintain its impact through at least the first half of calendar 2021. The resolution of Brexit negotiations and inauguration of the Biden administration in the US may settle markets somewhat, but are unlikely to generate composure.

President-elect Biden has been in talks with members of Congress to provide a range of measures to stimulate the US economy, and the EU is likewise taking whatever actions it can to generate growth.

We expect markets to remain unpredictable throughout 2021.