MAY 7 2020

THE CHALLENGES OF THE POST COVID-19 WORLD | SYCOMORE SHARED GROWTH & SYCOMORE HAPPY@WORK BY FRÉDÉRIC PONCHON

I. What could the post-COVID world look like?

With millions of people infected, over 25,000 deaths – and sadly, probably many more to come, the global economy at a standstill, unprecedented GDP losses in peacetime, over 30 million unemployed in a few weeks in the United States, and 3,500 billion dollars of additional fiscal spending to finance…. we admit it's rather difficult to remain upbeat.

Nevertheless, this unprecedented and particularly violent crisis – without leaving a blank slate – does offer a unique opportunity to rebuild a more resilient economy and a better, safer and more balanced world.

At Sycomore, we believe that the post-crisis world will be different. It won't be totally different of course, but we are not expecting business to revert to normal. Many investors and analysts are still viewing 2020 as a mere interlude, maybe to ease their anxiety. However, one need only look at the economic and stock market performances of the banking sector since 2008/2009 to understand that the consequences of a crisis as deep as the Covid-19 epidemic are severe and lengthy. One positive though is that the cards have been reshuffled and for many companies, this may lead to opportunities driven by existing trends that will either gain momentum in the years to come or provide solutions to new needs.

The crisis has highlighted a number of weaknesses with our economy and our societies that will need to be addressed. What are they?

The crisis has revealed that after decades of poorly planned globalisation, supply and production chains have become dangerously dependent on China. We expect business cycles to undergo deep transformations which will involve the de-globalisation and "re-regionalisation" of supply chains. These business models will be more costly, but more resilient, and all other things being equal, should support employment in Western countries in the years to come.

Central banks responded well and avoided a liquidity crisis, but it is clear that the monetary policy weapons used since the 2008/2009 crisis will no longer be effective in generating reflation and boosting growth – hence the fiscal stimulus plans and policy choices that should create a better equilibrium in how value is shared, with more allocated to work and less to to capital.

Finally, the major issue of ballooning government spending - and its consequences - will need to be addressed, not necessarily in the short-term but within the next few years. Higher taxes and tighter regulation? Some form of "re-regulation" is likely to be the price to pay for the financial rescue packages currently orchestrated by governments.

These three possible outcomes – de-globalisation, fiscal stimulus and a political shift in favour of the work factor – as well as an increase in taxes and ramped-up regulation are obviously bad news for corporate margins overall. Margins have already peaked and these levels will not be enjoyed for a while in the Western world. Hence the need to invest in companies that are able to increase their top line and absorb the rise in costs by deploying their operating leverage and pricing power, to generate robust earnings growth – the main driver for stock market returns over the long term.

II. Key corporate resilience factors

The issue today is to understand where companies can go to seek out some growth. Growth can either be generated within the industry in which they operate and/or stem from within their own organisation.

Very clearly, we believe that Healthcare is the first sector that should be favoured going forward. The current epidemic has proven, if this was necessary, that health is the largest and most fundamental societal need and is a prerequisite at individual level, but also for a nation and an economy. If health is viewed as an economic resource – the new national wealth – the epidemic has nevertheless put a spotlight on the state of healthcare worldwide, revealing that in many countries, the medical infrastructure was unprepared or ill-adapted. We are convinced that investments in this sector will accelerate even after the crisis and that these budgets will be ringfenced. This increased awareness will also affect the consumer’s perspective and will extend to hygiene and wellness considerations – with more attention given to coronavirus precautions, healthy eating and sporting activities.

The **second sector we would focus on** includes all players that enable or benefit from **digitalisation**. This is not a new trend, but user habits have been disrupted by the crisis, as demonstrated by the expansion of remote-working, e-commerce, on-line payments, on-line entertainment… A major shift has occurred: the digital penetration rate has made a huge leap forward and the investments needed to address these new user habits, which are likely to persist after the crisis, are huge.

Looking beyond the business sector, resilience and potential for growth are directly related to the company itself, its organisation, management, strategy and vision. Today’s crisis has put the spotlight on companies that can rise to the challenge; these will be the winning companies in tomorrow’s world.

The **first challenge**, despite the brutal economic shutdown caused by the lockdown, was to be in a position **to continue operating**. The main key to success lies in the flexibility of the company’s organisation: its ability to change direction and to introduce – if this was not the case previously – new ways of working, including from home, while adopting new forms of management. This can only happen for companies that value their human capital and whose employees, as a result, are engaged, keen to achieve collective success, empowered, well-trained and nimble. During the crisis and as we emerge from the situation, **human capital is a major differentiating factor that will drive resilience and the company’s ability to grow.**

Companies will have to rise to a **second challenge: gaining entrance into tomorrow's world by ensuring their social legitimacy.** The task of rebuilding a sustainable economy has to be a collective undertaking. Although governments are steering the economy in the midst of the crisis, their power will reach its limits and companies will be required to contribute to the common good. **A new social contract is falling into place.** Many companies have already made their products, expertise, production tools and balance sheets available for the common good. And in this respect, civil society expects a great deal from the corporate world. Companies that have understood this, display exemplary corporate citizenship, and offer solutions to societal challenges, will emerge from this crisis with an improved brand image and stronger market share, if only because limiting the negative impacts of the crisis for most of their stakeholders has protected their ecosystem, avoided its collapse, and made sure it remains operational to enable a faster rebound.

Though not exhaustive, these four key factors will be able to drive success, resilience and growth in the post-Covid world: exposure to healthcare, to digitalisation, the value given to human capital, and the importance of societal contribution as a key tenet of a company's strategy.

III. Post-COVID investment solutions

Two SRI thematic funds - Sycomore Shared Growth and Sycomore Happy@Work – are positioned to benefit from the tailwinds created by the transformations mentioned above. Furthermore, the health crisis is likely to inspire responsible investors to show more interest in social and societal dimensions – the themes developed by Sycomore Happy@Work and Sycomore Shared Growth - rather than focus on the more traditional environment pillar.

Sycomore Shared Growth invests in **companies that offer solutions to major global challenges and that have embedded this search for positive impacts** within their corporate strategy, in order **to deliver profitable and sustainable growth**. The fund's stock picking process focuses on the societal contribution of a company's products and services, as well as its corporate citizenship. We have indeed seen a correlation between these characteristics and a company's ability to create robust, visible and sustainable growth – this relationship is likely to be confirmed and become stronger in the post-COVID world.

I have been managing this fund since 2005. Structurally, the strategy's largest sector weighting is healthcare, a fundamental industry for society. The sector currently weighs around 40% of the portfolio. Our stock selection includes Sanofi, a company whose earnings, amongst others, will be boosted by governments' rising interest for flu vaccines (Sanofi holds 75% of the global market share) as they strive to avoid hospital emergency rooms and ICUs being overrun if a second epidemic wave occurs in the autumn or next winter.

Even China, where the flu vaccine is virtually unheard of, is considering vaccination programs. Philips and the German company Draeger are also seeing a surge in orders for respirators, and these companies offer a wide portfolio of hospital equipment for the years to come.

We also own stocks in the Italian company Sol, and in Air Liquide, that produce medical gas. Finally, at the crossroads between the digital and healthcare industries, the fund has invested in on-line pharmacies such as Zur Rose and Shop Apotheke, which have been able to recruit new clients with the crisis, and in Nexus, the German hospital software publisher.

This deep sector covers a variety of segments driven by different dynamics that are particularly interesting for stock pickers. The industry's recent resilience has helped the performance of Sycomore Shared Growth: the fund has only lost 7% while the EuroStoxx TR* index is down by 21%. This resilience is essentially down to the sector's robust activity, as 2020 earnings have only been revised downwards very marginally, while the broad market has seen revisions of -20 to -30%, sometimes more. It is interesting to note, for upcoming quarters, that the sector has not benefited from a rerating and that the investment super-cycle that we are forecasting for healthcare has not been factored in. Prior to the crisis, the sector was not particularly popular with asset managers, or over-weighted in portfolios, and it therefore offers an attractive upside potential. Outside of the health industry, though closely related, the fund is highly exposed to the rising demand for hygiene products through Reckitt Benckiser for example, and particularly to the health food industry, with companies such as Symrise, Corbion, DSM and Kerry that offer natural food ingredients able to preserve flavours while reducing salt, fat or sugar levels.

Sycomore Happy@Work invests in **European companies that pay considerable attention to their human capital, as a driver for resilience and growth.** This dimension has taken on its full meaning during the health crisis and will be a discriminating factor as companies emerge from the crisis.

Managed by Cyril Charlot, Jessica Poon and Sabrina Ritossa-Fernadez, the fund's originality stems from the analysis matrix and stock selection process, which are grounded in the belief that a company cannot enjoy an efficient and nimble organisation without:

- a motivated and empowered workforce, particularly in sectors that are switching to remote working;
- a shared strategy and clear vision enabling staff to find purpose in their work;
- a competent and empathy-driven leadership, which is only possible in meritocratic systems;
- a well-oiled training system where existing skills are acknowledged and new skills can be quickly learned;
- a human-driven vision, which encourages companies to carry out redundancies only as a last resort, as these companies are better positioned for the recovery if they have held on to their talents and maintained the trust of their employees.

Today's crisis has exacerbated reputational risk. Our research matrix aims to avoid this risk – closely related to human capital management issues - particularly for companies that address consumers directly based on brand images that have taken years and considerable investments to establish and achieve recognition. Disney is a good example. The company has carried out massive lay-offs while the pay gap between top managers (who earn 8 figure salaries) and the staff working in the parks in precarious conditions has already caused recurring controversies. This decision led to an avalanche of criticism in traditional and social media, and sparked a call to boycott.

Conversely, Hermes, Ferrari and EssilorLuxottica, portfolio companies that are admittedly in more comfortable financial situations, have announced they would keep their workforce and not apply for government relief, thereby preserving their image and the aura of their brands.

Sycomore Happy@Work has performed well in 2020, limiting its losses to under 12%. However, we believe that investors have not yet factored in the premium that these human capital leaders deserve. The crisis could act as catalyst, convincing the market of the importance of human capital. These human capital leaders include companies focused on innovation; imagining new and more efficient forms of organisation is one of the facets of innovation, particularly in the digital world. Our exposure to the digitalisation of the economy and the changing pace of this secular trend triggered by the health crisis exceeds one third of the portfolio, meaning that Sycomore Happy@Work is well-positioned to benefit from the post-Covid world.

These two investment solutions, which we are currently highlighting in our fund range, focus on the social and societal dimensions – which had been rather upstaged by other responsible investment themes until the health crisis erupted - but the environment and energy transition should not be forgotten. Some imagine that the crisis will delay the transition, while others believe in an environmental Marshall plan that would drive a “post-crisis reconstruction”. We fit into the second category. And we believe this issue deserves a dedicated webinar – for which you will soon receive an invitation - with a specific focus on the Sycomore Eco Solutions fund.

**TR: reinvested dividends.*
Data as of 30.04.2020, I share. The fund's performance may be explained in part by the ESG indicators of the portfolio stocks without these being the only determinants of changes in this performance. Past performance should not be considered a guarantee of future returns.

The funds may suffer capital losses.

Risk/Return Profile

Lower risk, Higher risk,

1	2	3	4	**5**	6	7

potentially lower returns potentially higher returns.

Major risks

- Risk of capital loss
- Equity risk: the risk that the value of a given stock may decline, impacted by a market movement, or by specific news flow affecting the company or the sector, due to the fund’s exposure to equity markets (from 75 to 100% of net assets).
- Liquidity risk, considering the small market capitalizations of some of the holdings in which the fund may invest.
- Interest rate and credit risk, as the portfolio can be exposed to debt and money market instruments (up to 25% of net assets).

- Currency risk, as some of the stocks within the investment universe can be listed in a currency other than the euro (max 10%).
- Specific risk relate to Sycomore Happy@Work: Up to 10% of the sub-fund's assets can be exposed to instruments from emerging countries. The value of these investments may be affected by economic and political incidents within these countries, potentially due to the weakness of their economic structures. If one or more of these markets depreciate, the fund's net asset value may also drop.