VERO BEACH GLOBAL ADVISORS
Registered Investment Advisor

United Kingdom 2018

David W. Griffis, CFA

When we named our firm and included the word "Global" it was not just for effect. We wanted to make a commitment to not only have a complete understanding of the family relationships under our care, but also those investments we selected to assist in accomplishing their respective goals. It is our belief that just understanding the businesses and their financial standing is an incomplete research process until we stand in the actual place where they conduct their business. This is why we can truly refer to our investment approach as "global". This year alone in addition to my trip to the UK we will conduct visits to Hong Kong, China, and India. Over the past few years our firm has also visited Western Europe, Southeast Asia, Germany, New Zealand, and Peru. Our 2019 travel plan is still formulating.

The primary objective for my visit was to continue the research efforts on several of our current and potential portfolio holdings by conducting in person meetings with their management teams and investor relations professionals. Secondarily, I wanted to get a feel for the overall economic climate in the areas I visited. The economies across Europe have been in a long-term malaise, with low growth and lackluster economics leading to disappointing recoveries following the financial crisis. Investing overseas over the last decade without adequate due diligence has been difficult. During this time period international stocks have outperformed domestic stock in only three years. On an average annual basis, international stocks have underperformed the S&P 500 by nearly 8% (no dividend reinvestment).

For the last few years the headlines out of the United Kingdom have been primarily around their referendum vote in 2016 to leave the European Union, also known as Brexit. Subsequent to the vote the economy, as measured by real GDP, has slowed, wages have declined and household economic losses have accelerated. Presently the actual exit, scheduled for 29 March 2019, is being ferociously debated in terms of "hard" and "soft", in reference to the ensuing relationship with the EU. It is uncertain what the macro effects of the referendum will be on the UK economy. Our challenge is to determine the effects on the UK companies we follow.

Currently estimates are around 1.3-1.4% real GDP growth for 2018 and 2019 with around 4% unemployment and 2.5-3% inflation. The low growth comes primarily from the subdued consumer spending, low capital spending and the collateral effects of Brexit. Although Prime Minister May has moved to soften their Brexit stance it appears the negotiations have stalled, and the timing of any deal is uncertain. This leads to the continuation of the biggest headwind for the UK economy presently, the uncertainty around the outcomes of their exit from the European Union.

Adverse weather hit the economy in the first quarter. However, there was a noticeable rebound in the second quarter which has continued into the third quarter. Low growth expectations for the remainder of the year should be enough to absorb any remaining excess capacity. Inflation has slowed as the effects of the significant pound depreciation have faded somewhat, and wage growth is now showing some life. The Bank of England increased rates in August and will most likely stay put until the third or fourth quarter of 2019, and any further moves will be data dependent, limited and gradual.

The current exchange rate is 1.3 GBP/USD. The competitive value of the pound has led to an increase in exports and tourism offering some support to growth that should persist into next year. This rate, in our opinion, is also constructive for buying and owning UK equities longer term. With the relative underperformance over the last decade there is significant value in UK stocks. While value exists, a major catalyst for stocks to realize that value does not. A Brexit deal would go a long way to releasing value, however, because the timing and content of any resolution remains uncertain the associated risks to this value are elevated at this point.

When planning my trip, I attempted to develop a sample of diverse companies that would give me a good view of the economy. I looked for companies that were from diverse sectors with varying global exposures. Most of my meetings were in and around London.

London has grown significantly faster than other parts of the UK over the last few decades, however, that relationship has been weakening and growth has moderated to nearly the level of the country in general. This has led to a decline in housing prices in London, and slightly positive growth in the rest of the country. To get a perspective I met with a large-scale builder headquartered in London who in spite of this trend has had excellent financial results over much of the last decade. They described an environment where government incentives, management decisions as well as buyer incentives have led to the excellent execution they have experienced. This execution has not made it to the stock price, hence our interest.

I also met with the second largest carbonated and still drink manufacturer and distributor in the UK (Coca Cola is #1). They are also the exclusive Pepsi bottler and distributor in the UK, and are at the beginning of an expansion plan into the US with their Robinson's Fruit Shoot and Hydro drinks. I wanted to explore the effects of a sugar tax implemented earlier this year and how they plan to get more market share from Coke.

I met with a global communications and satellite provider, one of the largest global providers in the maritime and aviation communication space. They recently cut their dividend under earnings pressure, and I was disappointed by their forward plans.

I spent time with one of the largest automotive, bicycle, and motorcycle parts retail chains in the UK, presently undergoing a major upgrade of their locations. An aerospace and defense company that include the US department of defense, US Navy and Boeing among their largest customers. A diversified industrial/technology company operating with a very diverse portfolio of businesses operating globally, incidentally with a division headquartered in Stuart Florida.

At each meeting I explored the Brexit issue in some detail to get a "domestic" perspective. In almost every case, save one, they stated that after the initial shock of the referendum it was business as usual. The companies, in all cases, have adjusted their businesses in an attempt to insulate themselves from what they view as their respective Brexit risks. However, they were also clear to say they would do the same for any existing headwind. In the case where the concerns have remained elevated the company operates almost exclusively outside of the country with what will become their former EU partners, and have significant concerns around the ultimate resolution.

My visit solidified our long-standing belief that being selective wherever you choose to invest, and owning the best businesses based on their own merits will yield greater results. Although there are economic issues that persist in the United Kingdom, valuations are constructive and there are some good opportunities for patient investors who remain disciplined, filter the noise, and remain diligent in their process. We continue to believe the UK is an important investment thesis for our clients, and we will maintain our research efforts to continue to identify opportunities.