FOREWORD

Dear Reader/client,

Half-way through 2021 and the pandemic – certainly in the UK – seems to have entered a new phase. The delta strain is causing new cases to rise considerably, but not hospitalisations. How policymakers deal with this remains to be seen, but at the moment, it seems that re-opening of our economies will continue as planned.

Economic sentiment has rebounded sharply and equities have continued their long rally. Underneath the hood there have been sharp variations between the value and growth styles indicating it is not all plain sailing.

Faster economic growth expectations have brought with them increased concerns about higher inflation and tighter monetary policy. We continue to believe that such concerns should ease in time. Nonetheless as the COVID-19 recovery matures, we need to be mindful of the risk that either growth disappoints, or central banks may be pressed quickly into action.

Our investment style has held up well as we pick stocks which have structural growth drivers and can pass through price increases. Whilst maintaining our positive outlook, our strategists and portfolio managers are bringing some caution to portfolio positioning.

We hope you enjoy reading about this in further detail and wish you some relaxing time over the summer.

Richard Brass
Head of Wealth & Asset Management, UK

ADVISORY

IN A NUTSHELL

- Mixed market sentiment continues despite rising inflationary concerns.
- High proportion of US and UK population have been vaccinated and lockdowns are gradually easing.
- Reduced risk with sale of Talanx and trimming of Whitbread.

Overview

Despite rapid vaccinations, the emergence of the delta variant has imposed concerns of infection rates once more. Compounded with this, pent up demand and spending is evident with the easing of lockdown restrictions driving inflation and therefore giving rise to concerns of interest rate hikes sooner than initially expected.

With this in mind, growth stocks have lagged during this period as their future cashflows are more tilted towards the long end and will be worth less in Net Present Value terms if interest rates were to rise. Our portfolio holdings at large have lower valuations, reasonable organic growth rates of up to 10% and strong pricing power. Hence, we believe we are well positioned even if inflationary concerns will materialise in the future.

Despite the risk of interest rates rising, we believe with the emergence of new variants and the position of Central Banks generally allowing economies to run above inflation for a short period of time, the concern of interest rate hikes may be premature/overdone. With this in mind, we saw an opportunity to crystallise the position in **Talanx**. The stock has rallied over 30% since our purchase in October 2020. With rising inflationary concerns and subsequently higher yields, its investment portfolio may suffer in the short term.

Furthermore, we believe optimism around lockdown easing could be excessive given travel restrictions for holidaymakers (particularly for short city breaks) and potentially subdued business travel for a longer period of time. As a result, we believe **Whitbread** will suffer from lower bookings than hoped in the latter half of the year. With this in mind, we halved the position in the company.

Tomra had performed strongly over the quarter rising 28.6% in light of its strong order intake, alongside **AstraZeneca** (AZN) which had recovered from headwinds concerning the rare cases of blood clots from its COVID-19 vaccine and progress in its oncology and Cardiovascular, Renal and Metabolism ("CVRM") division. Furthermore. AZN has received approval from all important regulators for the USD 39bn takeover of Alexion.

THEMATICS

As indicated in our initial Quarterly Review, every quarter we discuss a key topic within one of the four core themes[1] to raise the awareness of them and display how these trends feed into our stock selection. For this quarter we delve into the theme of Demographic Change, namely the trend of urbanisation.

Urbanisation shapes societies and economies …

Today, more than half of the world's population reside in urban areas. As a result, cities grow larger and become more densely populated. While Tokyo is the largest city with more than 37m dwellers, Dhaka is the most densely populated city with 44,500 people/m^2 (to compare the UK has a population of 68m people and a population density of 275 people/m^2).

As people move into cities, it not only changes the general urban appearance, but it also affects the way we live, consume, work and/or commute. Some studies show that urbanisation is likely to stimulate both innovation and economic growth. As cities grow larger in terms of height and area, connectivity and transportation become critical elements in urban planning.

… with differences across regions …

Countries across Asia, Latin America and Africa have experienced the highest growth rates in terms of urban population. In Asia, the percentage of people residing in urban areas has increased from 17.5% in 1950 to 51.1% in 2020 and is projected to reach 66.1% by 2050. In comparison, the urban population in North America has grown at a substantially slower pace due to its higher base level, being 63.9% in 1950 and 82.6% in 2020.

… attributable to natural population increase, migration, urban sprawl

Urbanisation is broadly driven by three key factors. Firstly, urban population may rise due to a higher growth rate of the incumbent urban population as a result of longevity. Better access to health care systems tends to result in lower mortality rates in urban areas. Provided that births exceed deaths, and birth rates exceed mortality rates, this will cause a natural increase in urban population.

Secondly, migration plays an important role. People seeking higher job salaries or better education tend to reside in cities.

Finally, urban sprawl captures a higher number of people thus increasing the urban population. It is often observed that fast-growing cities incorporate adjacent areas and their populations in the course of urban growth.

Urbanisation: moving into cities – Otis: moving within cities

We believe that **OTIS Worldwide**, the world's largest elevator and escalator manufacturer, will be a key beneficiary of the urbanisation theme. In providing buildings and outdoor spaces with both elevator and escalator maintenance and installation, OTIS moves 2 billion people in more than 200 countries a day. Famous projects include the Shanghai World Financial Centre, Christ the Redeemer, Bahrain World Trade Centre, Empire State Building, Eiffel Tower, Abu Dhabi Airport and Lotte World Tower.[2]

OTIS is a truly global company and the largest player in the elevator OEM industry, followed by Schindler and Kone (the Big Three listed companies). Given the strong market position (15% market share), OTIS may significantly benefit from organic market growth. Urbanisation and sustainability are likely to be the key drivers of future market growth in the elevator space.

[1] (i) Demographic change (ii) Innovative and disruptive technologies (iii) New energy and resource management (iv) Future health and wellness

[2] https://www.otis.com/en/vn/our-company/global-projects/project-showcase

… providing smart and innovative solutions.

The trend towards more sustainable cities and communities (SDG 11) requires cities to take into account factors related to energy efficiency and connectivity. OTIS is known for its innovation capabilities and has been at the forefront of sustainable technology and resource efficiency. Innovative solutions enable the company to operate elevators, which consume 75% less energy than conventional systems.[3] In addition, the company's aspiration to deploy artificial intelligence and the internet of things contributes to making cities smarter and more efficient.

Long-term growth prospects paired with strong financials.

Taking a closer look at OTIS' financials suggests that the company is well positioned for sustainable future growth. The quality of the firm's business model and balance sheet have proven remarkably strong after last year's COVID-19 acid test. While sales have declined by only 2.8% in 2020, a relatively strong net income result of USD 1.1bn has been reported. In addition, Free Cashflow yield was 3.9% in 2020 and an increase in capital expenditures is representative of the firm's growth strategy.

The world of tomorrow: urban, sustainable and connected.

Urbanisation changes how people work and live. The world is becoming faster, smarter and taller. As a result, innovative and eco-friendly connectivity solutions play a vital role in modern societies. Moving people over long distances, both vertically and horizontally, ensures the frictionless functioning of urban life. OTIS provides innovative, smart and sustainable solutions all over the world. As OTIS has a strong market position in a market with significant growth potential, we believe that it is an attractive long-term urbanisation play.

The following section includes excerpts of portfolio manager commentaries. Should you wish to have further details on a particular strategy, please contact the authors of this document.

[3] https://www.otis.com/en/us/our-company/sustainability

BERENBERG BASKETS & FUNDS

IN A NUTSHELL

- Despite markets experiencing shifts between value and growth styles over the quarter, performances across the board have been resilient.
- Equity prices are mostly rising as a result of lockdown easing, good vaccine progress and resulting strong economic data.

HEALTHCARE

Robust economic data and positive earnings revisions led to mostly rising equity prices in the second quarter. Improved investor sentiment due to the COVID-19 vaccination progress and the reopening of the economy acted as a support. Similar to the first quarter, we again witnessed shifts between value and growth investment styles. However, after a long period of underperformance, the European Healthcare index significantly outperformed the wider equity market during the quarter. The cyclical trade in equity markets has lost some of its momentum as positive macroeconomic surprises have probably peaked. Hence, investors seem to increasingly look for opportunities in defensive sectors, which trade at historically attractive valuations.

Winners & Laggards

The outstanding contributor to portfolio in this quarter was **Lonza**, the Swiss provider of outsourced drug development and manufacturing services to pharmaceutical and biotech companies. Shares have moved sideways since mid-2020, after a strong run during the initial phase of the COVID-19 pandemic as investors had shifted away from defensive stocks and shares had re-rated too strongly. The trigger for the strong bounce was the FDA approval of Biogen's Alzheimer drug Aduhelm, which was a huge surprise to the medical and investing communities. While it is not entirely clear whether Lonza will be directly involved in the manufacturing process of the drug, as details around customers and Lonza's involvement are typically kept secret, it seems very likely that Biogen cannot handle the manufacturing of such a drug alone given the significant unmet medical need. Even if Lonza was not directly exposed, given the high capacity requirements for this drug, Lonza will indirectly benefit as the risk of the industry experiencing overcapacity is reduced significantly. Following the Biogen news, we immediately topped up our position and the shares have appreciated nicely since then.

Another strong performer in the portfolio was **Novo Nordisk**, the Danish pharma company focusing on diabetes and obesity care. The company raised its full year guidance on the back of an encouraging first quarter. This has been the first Q1 guidance raise for the company in 10 years. Management is seeing strong top-line momentum. The important GLP-1 franchise is progressing well and US insulin pricing is less of a headwind this year compared to 2020. Furthermore, the shares benefitted from investors shifting into more defensive assets during the quarter. During its recent R&D call with analysts and investors, we received confirmation for our investment case: firstly, the company continues to improve its competitive position in diabetes. In addition, Novo continues to innovate on GLP-1s, where we also see attractive pipeline opportunities. Secondly, the company's move into adjacent therapies like obesity care, cardiovascular disease, chronic kidney disease, non-alcoholic steatohepatitis and Alzheimer's disease seems to progress according to plan, supporting the long-term growth profile of the company.

Our position in the German provider of discovery and clinical research services **Evotec** also performed strongly during the quarter. The company held a supportive capital markets day in April, which reaffirmed our investment case. Essentially the company plans to triple its EBITDA between 2020 and 2025. A significant driver of this strong guidance is the increasing importance of Evotec's biologics business called Just Evotec Biologics, which is currently in the process of ramping up significantly. The business will carry higher margins than Evotec's "legacy" business once it reaches a significant scale. Another driver of strong profitability gains is the higher growth of milestone and upfront payments, which is a result of Evotec's investments into its Innovate business and its proprietary portfolio of drug assets over recent years. Q1 results presented in May were also strong and supported the good momentum we are seeing in the business currently.

After a very strong performance in 2020 and the first quarter of this year, shares in **Ambu**, the Danish manufacturer of single-use endoscopes, were sold off. With its second quarter results, the company announced that they are going to launch a version 1.5 of their duodenoscope in October to incorporate feedback gained from physicians during the early launch and to have the best possible product available on the market ahead of an improved reimbursement policy. In addition, the company spoke about a more gradual penetration of single-use technology for duodenoscopes. Investors were bracing for a strong ramp-up in sales for this product in the second half of Ambu's fiscal year 2020/21 and hence these comments reset investors' expectations, leading to a significant weakness in the shares. While we were surprised by this announcement as well, after speaking to the company, we were left with the impression that management realised that their product is slightly inferior to Boston Scientific's competitor product Exalt-D, and consequently decided to pull forward new product features. With these features, the product should perform well and see stronger uptake from physicians. In addition, the share price move and analysts' downgrades result in the market pricing in very limited contribution of the duodenoscope for quite some time. We regard this as a relatively pessimistic scenario and could hence see positive surprises going forward. We did not increase our position at this stage as uncertainty for the next months will remain elevated and as investors will only get more clarity towards the end of this year or early next year.

MorphoSys, the German biotech company, was another negative contributor to performance. Shares had already been weak before due to the COVID-related delays in the launch of its main product Monjuvi. However, the company's acquisition of Constellation Pharma for USD1.7bn caught investors by surprise and shares reacted negatively. The fact that MorphoSys did an acquisition was not a surprise given its very strong balance sheet; however, the deal was significantly larger than expected and the deal structure was rather complex, as it involved financing arrangements with Royalty Pharma, the leading acquirer of royalty streams in the pharmaceutical industry. Under these arrangements, Royalty Pharma does not only invest USD100m into MorphoSys, but also acquires its royalty interests in Tremfya (100% of royalties), otilimab (80% of royalties, 100% of milestones) and ganterenumab (60% of royalties) for USD1.425bn to finance the deal. The deal was received negatively as MorphoSys has effectively traded a more mature revenue stream – Tremfya is an approved drug – for Constellation's pipeline, which is interesting but also carries higher uncertainty. We continue to believe that MorphoSys has interesting pipeline assets but acknowledge that investors will now want to see more proof of the potential of the Constellation assets.

Philips, the Dutch healthcare conglomerate, also contributed negatively. We trimmed the position in April and fully sold our position in May. The reason behind these trades was our clear relative preference for Siemens Healthineers, which is a significant competitor to Philips for its diagnostic imaging business. Furthermore, Philips announced with its Q1 results in late April that it took a provision for a quality issue in its Connected Care business. We were reminded of historical hiccups of the company and hence decided to fully sell the position. Later in June and after our sale, the company announced that it had to recall the product and that the resolution will be more costly than thought initially.

Transactions

Directly after its initial public offering, we bought into **PolyPeptide**, a leading contract development and manufacturing organisation (CDMO) for peptide drugs. The peptide CDMO market is distinguished by an oligopolistic market structure (PolyPeptide is global #2), higher barriers to entry (high importance of reputation, long-standing customer relationships, high capex requirements and scientific expertise) and structural growth given the growth of the underlying peptide therapeutics market and increasing outsourcing. The company is guiding for a low double-digit organic growth in the medium term and we see upside potential to this guide given the strong phase 3 pipeline, the opportunity in oligonucleotides and antigen peptides and customer-specific projects (e.g. Novavax). Margins are expected to increase further to c. 30% EBITDA margins while capex is increasing due to the strong growth prospects. In short, we view PolyPeptide as a "small Lonza" with more dynamic top-line growth if some of the optionalities materialise but a slightly higher risk profile. We financed the position with the sale of Abcam, the UK provider of antibodies for research applications. Abcam remains a high-quality company with attractive growth prospects, but its valuation is significantly above historical levels, which limits the upside in our view.

In addition, we topped up our already significant position in **AstraZeneca**, the UK-Swedish pharma company. We believe the shares have been unduly punished by discussions around its COVID-19 vaccine and its planned acquisition of US biotech company Alexion. The vaccine discussions are now in the rear mirror and investors continue to get more comfortable with the acquisition. In addition, the company delivered an encouraging Q1 and pipeline updates have been positive. We continue to regard AstraZeneca as the fastest growing pharma company in Europe, which is trading at attractive valuations. Further pipeline read-outs in the second half of 2021 could further boost the shares.

We also increased our position in **Cellink**, the highly innovative Swedish life science company. The shares had a very strong run since we purchased a position in February but were then sold off in May after its Q1 results which did not meet analyst expectations. In our view, the company communicated poorly with the (new) analysts ahead of the quarter, as analysts disregarded the weak seasonality of Cellink's Ginolis subsidiary and hence expectations set by the analysts were unrealistic. In our view, fundamentals remain strong and these irritations have provided an attractive entry point.

GLOBAL

Winners & Laggards

Facebook won an interim victory against antitrust allegations made by the FTC and 46 US states. US Judge Boasberg does not view Facebook as a monopoly and the acquisitions of Instagram and WhatsApp were deemed as lawful. Additionally, comments from Mark Zuckerberg regarding the impact of the IDFA were supportive of the stock price. The CEO expects a defensible effect on revenue and even an acceleration for the demand of its shopping functionality.

After a difficult first quarter, the share price of German meal-kit provider **HelloFresh** has gained nearly 29% in the last three months. While investor concerns about the sustainability of the stock's strong growth due to the pandemic caused hesitation in the first quarter, the Berlin-based company was able to remove much doubt by raising its full-year outlook in the second quarter. In addition to the company's good operating performance, its low valuation relative to other online companies was another reason for its strong share price performance.

The share price of Swedish medical technology company **Addlife** increased significantly in the second quarter. This was due to two major strategic acquisitions, which could help Addlife gain a foothold in new geographic markets and product categories. In particular, the acquisition of the Irish company Healthcare21 created a positive sentiment, as Addlife can now also serve the entire UK market with this acquisition.

Interactive Brokers' stock showed a weaker performance in the second quarter as investors expect a slowdown in new customers and trading activity. Trading volumes should remain at solid levels in the coming quarter, although not as high as observed in the first quarter. Management is confident about new customer acquisition for the remainder of the year as it looks to gain significant market share in its international business. Valuation still looks attractive at a P/E of 20x for 2022. Analyst earnings estimates are conservative and allow for further upgrades next year.

Ryman Healthcare, the New Zealand developer and operator of senior residences, underperformed in the second quarter. The company suffered delays in new housing development as a result of COVID-19 induced lockdowns and restrictions on construction, causing the company to sell fewer new units. These sales are important sources of revenue for Ryman. Although the situation has eased considerably over the past few months, with sales picking up strongly in March and April, the company announced that it expected to add 900-1,000 new units in the following fiscal year. This was below our expectations and also those of the market. In addition, CEO Gordon MacLeod announced his resignation for private reasons. MacLeod had been with the company for 14 years and we have always had a positive perception of the company's management. However, we do not anticipate any major transition issues. Chairman David Kerr is very involved, and MacLeod will not leave the company until his successor has been trained.

As discussed in the healthcare update, after a strong share price performance since buying **Ambu**, the Danish manufacturer of disposable endoscopes, in the fourth quarter of last year, more recently the share price fell significantly.

Transactions

Alibaba had dealt with some challenges in recent months including the cancellation of the Ant Group IPO, regulatory headwinds and fierce competition in the e-commerce space. However, there are some hints that the tide may now be turning. According to the company, the regulatory investigations are over and they are making good progress against competition with the new Taobao Deals and Taobao Grocery platforms in rural areas. The stock stabilised at low levels. In addition, the valuation was historically cheap with a P/E 2022E of 18x as EBITDA growth should be in the 20s despite investments. In the past, these were the times of solid outperformance in the years after.

We added slightly to **Facebook** again after some weakness in May. First quarter numbers were solid with 48% growth and management does not expect a significant impact on the business despite Apple's IDFA transition. On the contrary, Facebook and Instagram's store penetration may even increase. The valuation at purchase was very attractive at 20x P/E 2022E. In addition, as previously mentioned, Facebook was able to achieve an interim victory against the antitrust allegations made by the FTC and 46 US states.

After the share price decline and stabilisation, we added to our small position in **Teladoc**. We believe the company has built a strong competitive position that is difficult for competitors to replicate in the "digital healthcare visits" space. Over the past few quarters, Teladoc has laid a strong foundation with Primary Care 360 (a virtual service for primary care visits), building out its Chronic Disease Management business (or Livongo acquisition), and expanding other services such as Mental Health. In the near term, the focus will be on unifying these services on the platform and increasing the number of physician visits, so it depends on the execution of the company. Of course, it is not clear today how many visits will also be held digitally after the COVID-19 pandemic. However, we assume that the pandemic has led to a sustained demand for digital solutions. The company's valuation has become much more attractive, and analyst estimates appear to us to be very conservative and below the company's medium-term guidance.

Following the strong short-term performance of **KKR**, we reduced the position. The Capital Markets Day in April was an important trigger to confirm the medium-term targets, which have now been included in analysts' estimates. The valuation at the current price level leaves less room for outperformance, which is why we decided to reduce the stock.

Following a strong performance of the stock, we also reduced our position in **Interactive Brokers** after adding to it at the beginning of the year. The company reported robust new customer growth as well as record highs in trading volume and margin loans. The global expansion strategy together with positive market sentiment were reflected in solid numbers. The rise in interest rates in the US was also an important driver of equity performance. After this strong price movement, the relative attractiveness shifted again somewhat more in the direction of higher-growth stocks, such as ServiceNow.

The **Infineon** share price consolidated in the last quarter. The shortage in the chip sector is weighing on supply in the automotive market, which means that Infineon has little surprise potential on the sales side. Demand looks solid, but the shortage of key components will negatively affect Infineon. The situation could drag on until the end of the year, after which we expect the matters to ease again. Aside from this, Infineon's base business performed very well in the last quarter.

We sold our position in **Xero**, which had experienced a very strong share price performance since its purchase. Growth is likely to slow in the coming year due to the already relatively high penetration rates in the core markets. On the cost side, Xero will probably have to invest more again, which could weigh on margins. As the stock was trading at a historically high valuation, both in absolute and relative terms, we exited the position.

We also sold our position in **Addtech**, one of the leading industrial components trading companies. Addtech has been improving its product offering into solidly growing niches and has benefitted from strong valuation expansion along with margin expansion. We saw limited upside potential after the move and sold the position with a strong gain since purchase.

MITTELSTAND

Winners & Laggards

As discussed in the Global Fund update (see above), **HelloFresh** was among the top stocks in the portfolio after gaining nearly 29% over the past quarter.

Steico's share price continued to develop very positively in Q2 after the company raised its forecast in April. The company's order backlog remains very good and the company is fully booked for the foreseeable future, with delivery times extending accordingly. Despite the significant price increases for e.g. sawn timber in recent months, the company is less affected by this as it has a very good standing with the Polish government, from which it purchases approximately 90% of its timber on fixed terms through closed tenders. Three price increases in 2021 will help to more than offset the negative impact of raw material price increases, which management estimates at around 4-5%.

Secunet's stock performed very well in Q2 after the company significantly raised its 2021 outlook following a very strong first quarter. In Q1, the company grew 118% on strong demand for SINA products, particularly the new generation of tablets used by government agencies for secure communications, as well as the placement of healthcare connectors with doctors and pharmacies as part of the telematics infrastructure. The company also announced the acquisition of stashcat. Stashcat enables secure, compliant messaging with integrated file storage and video conferencing capabilities. More than one million users already use stashcat. This expands the product offering around SINA hardware for government agencies. Another piece of positive news is that the EU Parliament has approved the introduction of the common biometric entry/exit system (EES) for registering all travellers from third countries. From 2022, travellers from third countries will have to register with four fingerprints and a facial image when entering countries in the Schengen area at land, sea and air borders. The data will be stored in the EES along with identity details and other information from the travel document. Secunet offers technologically leading border control systems and kiosk solutions.

Morphosys' stock performed less positively in Q2. The company announced a transformative acquisition in which it acquired Constellation Pharma of the US at a 70% premium. To finance the deal, the company received a cash infusion from Royalty Pharma, which now holds an equity stake in Morphosys in return for royalties from several approved and future pipeline assets, such as Tremfya and otilimab. Due to the increased risk profile of Constellation's pipeline assets, investors initially reacted negatively to the news. Morphosys management was very optimistic about the potential of the pipeline assets and the company's diversification into epigenetic agents with a focus on (among others) prostate cancer, for which they see a significant unmet medical need.

TeamViewer's share price has significantly underperformed since the announcement of its first marketing partnership with Manchester United. Many investors were surprised by the announcement of such significant partnerships as a marketing channel, as the company had not previously considered it. In this context, these partnerships have brought a reduction in short-term EBITDA margins of approximately 6 percentage points. In addition, the recently reported Q2 numbers disappointed, with lower than expected growth. However, the long-term outlook remains promising, and the marketing spend should have a positive impact over time.

Transactions

In the past quarter, we established new positions in **Energiekontor** and **Cherry**. We increased our positions in **Bechtle, Morphosys, Nemetschek**, and **Stroeer**. We reduced our exposure in **Suess Microtec, Aixtron, Elmos Semiconductor**, and **Jungheinrich**. We sold our position in **Jenoptik**.

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IMPORTANT INFORMATION