PACIFIC ASSET MANAGEMENT

ARTICLE 8 SFDR

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is proud to be a signatory of:
PRI Principles for Responsible Investment

PACIFIC LONGEVITY AND SOCIAL CHANGE

INVESTMENT INSIGHTS

January 2023

TIMES LIKE THESE

The MSCI World Index was up 1% (in GBP) in the quarter to the end of December taking full-year 2022 performance to -8.4%. The year ended with another round of rate hikes by the developed market central banks which came despite moderating inflation data. Headline US CPI inflation slowed in November and October, as commodity price pressures and global supply chain bottlenecks continued to ease. However, the labour market remains tight, with historically low unemployment in both US and Europe and the December FOMC meeting signalled continued tightening in the new year with a similar rhetoric emerging from the ECB.

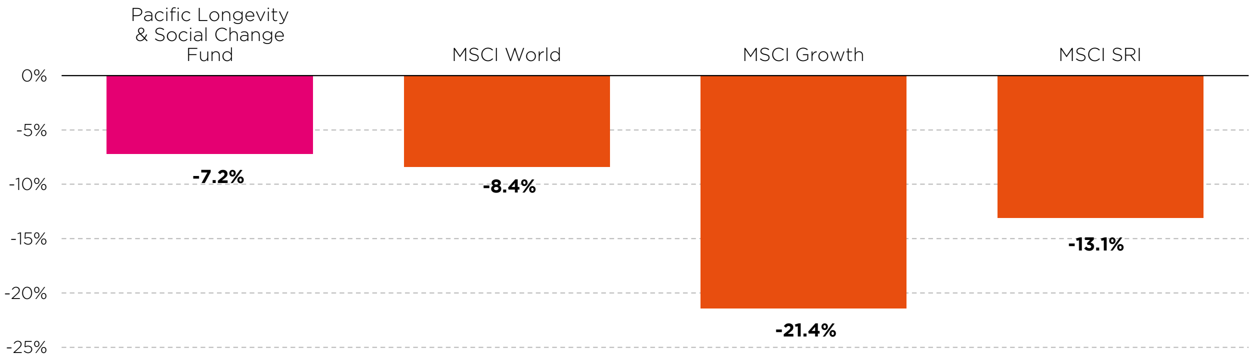
Looking into 2023, improvements in supply chains may provide support to corporate earnings in the near term, while China reopening should gather momentum once the current wave of Covid infections subside. Nevertheless, the possibility of central bank overtightening, geopolitical uncertainty and eroding savings still present risks to growth with many market observers predicting the US will slip into a recession during the third and fourth quarter 2023. Notwithstanding this backdrop, we remain optimistic that the Longevity Consumer is well positioned to demonstrate relative resilience in this uncertain time, underpinned by stronger savings balances among the longevity population and relatively inelastic demand for healthcare in particular.

Portfolio positioning and performance

The Pacific Longevity & Social Change strategy outperformed the MSCI World index during the fourth quarter (+6% in GBP), helped by the performance of Consumer Discretionary, Healthcare and Financial holdings. The top three absolute contributors to Fund performance in December were Horizon Therapeutics, Service Corp and EssilorLuxottica. The primary detractors were Catalent, Axonics and Guardant.

Our Consumer Discretionary holdings performed strongly ahead of sector peers in the quarter, driving nearly half of our outperformance relative to the benchmark despite the sector being the bottom performer in MSCI overall. Service Corp, Columbia and Brunswick were the highlights with support from most of our positions in the space. We expect quality consumer brands to remain resilient in the near future, supported by leaner inventory levels, easing supply chain headwinds, innovation and ongoing reopening in China. The Healthcare sector was the second best performer in the MSCI index during the period and our high allocation to the sector, with a solid month across the Fund's Healthcare holdings boosted overall performance. Horizon Therapeutics, EssilorLuxxotica and Transmedics had the strongest quarter with Horizon notably the subject of a takeover offer from Amgen. Our Financials holdings also outperformed in the quarter, helped by the rerating of our capital markets positions and a strong bounce in Allianz among the insurers. Lastly, our Consumer Staples holdings outperformed the benchmark helped by the performance of Haleon in December, which re-rated after a favourable US court ruling in relation to Zantac MDL litigation.

2022 Performance – Outperforming MSCI World, MSCI Growth and MSCI SRI



Past performance is not necessarily a guide to future performance. Performance is shown net of fees.

Source: Pacific Asset Management, Jan 2023

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2022 has been a challenging year for performance but by focusing on high quality growth stocks and maintaining a broadly diversified portfolio across sectors and holdings, **the Fund outperformed the MSCI Growth Index by 14.2%** (-7.2% vs -21.4% in GBP), the **MSCI SRI Index by 5.9%** (-7.2% vs 13.1% in GBP) as well as its **reference benchmark by 1.3%** (MSCI World -8.4% in GBP). This outperformance materialised despite the Fund excluding Energy and Commodities from its investable universe - partly on ESG consideration grounds and partly due to a lack of a clear link to the Longevity theme. In 2022, the Energy sector outperformed materially, delivering a 55% return hindering the relative performance of the Fund by 2.1%.

2023 Outlook

While the pandemic has weighed heavily on many businesses over the past few years, the outlook for the Longevity and Social Change universe remains robust. Across the globe, populations continue to age and this creates opportunities for companies that provide products and services which cater to changing consumption patterns driven by shifts in demography. However, a diversified approach to portfolio construction is also required in a stagflationary environment. Business models will be stressed, brand strength challenged, and both the innovation capabilities and relevance of companies' offerings will be tested.

Time for something HUMBLER

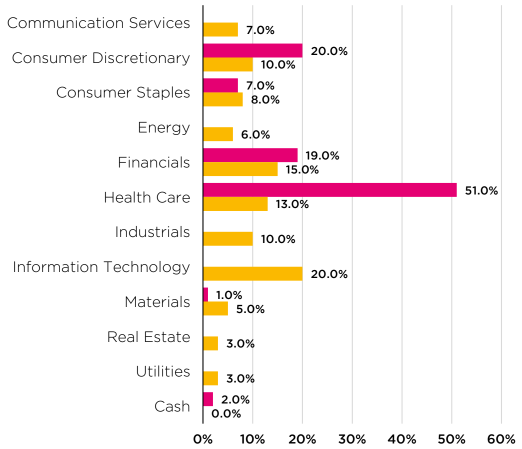
The past decade was dominated by Big Tech with investment opportunities spanning electric cars, social media and the cloud. However, coming out of the pandemic, Healthcare, in all of its manifestations (biotech, diagnostics, genomics, pharma, medtech) has proven its worth and in our view is the sector that will lead the economy in the next 10-20 years, prolonging healthspans, extending lifespans and driving more efficient delivery of healthcare services. Tech will still play a critical role in society as an enabler of healthcare, whether it be via using AI for drug discovery or NLP to analyse medical records to identify at risk patients earlier. However, we believe Healthcare and Consumer Health will become a more desirable investment versus Tech and other growth sectors over the near to medium term. In turn, an extended wealth accumulation phase from longer working careers will drive increased demand for financial planning and insurance services – notably savings, wealth transfer and annuity products.

HUMBLER represents a small cross-section of Healthcare, Consumer Health and Financial Planning companies that offer attractive growth and some level of protection from the harsh macroeconomic outlook. Business variability among this selection of companies should prove more stable compared to other sectors within the market. Large-cap Pharma and Managed Care were two of the most consistent Healthcare sub-groups in 2022 and we believe this performance will continue. In turn, we believe this will feed into other areas within healthcare such as Medical Devices and Diagnostics, who are likely to be viewed more favourably, as the likes of Tech/Retail/Industrials fend off recessionary pressures. Aside from the tailwinds benefitting Financials from longer accumulation and decumulation horizons, we also view it as an attractively valued sector underpinned by compelling yields and strong capital positions.

The Longevity & Social Change fund has over 50% of its assets invested in Healthcare, much of which offers 1) defensive growth (inelastic demand/secular growth through periods of uncertainty); 2) high margins (typically insulated from inflation given agriculture and energy are not significant inputs); and 3) pricing power at undemanding valuations relative to expected growth. Healthcare has experienced secular growth for several decades due to favourable demographics (ageing and growing middle-class population) and breakthrough innovation. Based on consensus estimates, Healthcare is expected to continue generating healthy mid-single-digit revenue growth while enjoying tech-like margins. Most Healthcare sub-industries earn margins north of 20% given patent protection and scale, while Biotech (38%) and Pharma (30%) generate among the strongest margins of all S&P 500 industries (in line with or higher than scalable Software and Internet Services). While drug pricing and Healthcare margins are often a target of political rhetoric, post the passing of the Inflation Reduction Act and Republicans seizing control of the House at the US midterm elections we expect a relatively benign legislative environment for the sector going forwards.

Source: Pacific Asset Management, Jan 2023

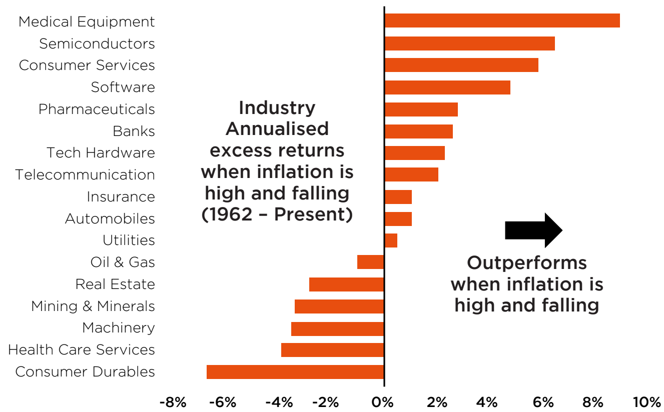
Sector Breakdown vs Benchmark (%)



Source: Bloomberg

- Pacific Longevity and Social Change Fund – Representative
- iShares MSCI ACWI ETF

Median subsector performance during periods of high and falling inflation



Source: Goldman Sachs research

Concerns over consumer resilience amid high inflation, stagnating real incomes and a persuasively hawkish Fed has weighed on Consumer stocks since the start of 2022. However, consumer weakness is not broad-based, and we see a bifurcation in spending with resilience in the luxury, premium and services space as well as continuation of sector specific secular trends. For example, Petcare is continuing to benefit from a higher degree of pet ownership, premiumisation of the market and low-price elasticity of demand. The Pacific Longevity & Social Change fund has significant exposure to Consumer Staples and Consumer Discretionary (~30% of the portfolio). We believe companies with high gross margins and pricing power should fare better in a world that is shifting from "an abundance of growth" to relative "scarcity of growth".

With the cost of capital climbing and real incomes shrinking due to inflation we believe companies with strong management and a track record of execution should prove to be good long-term investments. We remain focused on identifying high quality companies with proven operating models and strong innovation characteristics that have exposure to the durable and resilient growth offered by the Longevity and Social Change theme.

PLEASE GET IN TOUCH

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