UBAM - GLOBAL EQUITY

Quarterly Comment

Marketing Communication

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Market Comment

- The last quarter of the year pushed global equity markets higher with another rally and +11% gains for the MSCI AC World. US equities rose +11.2% in Q4, Emerging Market equities +7.9%, European equities +6.4%, Japanese equities +2.9% and Swiss equities +1.4% (performances in local currencies). Over the full year 2023, the MSCI AC World delivered +22.2%, with most regional markets finishing the year in the green despite limited market breadth and elevated bond yields.
- As expected by the market, the Fed announced no change in its key rate policy in December, mentioning the pressure of financial conditions on global activity and alluding to potential interest rate cuts in 2024. The US GDP growth projection for 2024 was revised slightly down from 1.5% to 1.4%, whereas Q3 2023 growth came in strong at 4.9%, lower than the 5.2% expected, but higher than the 2.1% for the prior print, reducing hard-landing fears. The yearly trend in US headline inflation marginally declined from 3.2% to 3.1% as core inflation remained stable at 4.0% yoy. The ECB also held its key rates unchanged as Eurozone inflation gradually eased to 2.4% yoy, slightly above the 2% target. 2024 earnings growth expectations for global equities remained stable at 10%, coupled with 16.6x forward PE ratio. This growth expectation reflects a broad recovery in corporate earnings in all major markets, which will probably, at least partly, depend on inflation and interest rate trajectories.
- The stock market has surprised investors over 2023, which had started with recessionary fears projecting more muted performances. The year also saw a large divergence in results between US IT mega cap names and the rest of the market, drawing a challenging environment for active fund managers. However, Q4 revealed mixed performances for the “Magnificent 7”, with Tesla largely lagging the remaining 6 names and the rest of the market. This has again shown the importance of a medium to long term view and the benefits of staying invested in the market based on a solid fundamental stock selection process rather than trying to time sector or thematic rotations.
- Over Q4, most sectors of the MSCI AC World delivered positive performances, except for Energy. IT, Financials and Industrials were the largest contributors to the index’ performance, whereas Energy, Utilities and Real Estate were the largest detractors. Top contributing names over the period were Microsoft, Apple and Amazon and the largest detractors were Exxon, Chevron and Pfizer. Growth and Quality investment styles outperformed the overall market and the other styles over the quarter, with Value and Momentum underperforming.

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Performance Review

- UBAM - Global Equity delivered +12.6% in gross performance over the fourth quarter of the year vs +11.0% for the MSCI AC World. Both the selection effect, particularly in the Industrials sector, and the allocation effect, especially the underweight in the Energy sector, contributed positively to relative performance with +0.8% each. Over the full year, the fund is up +18.6% on a gross basis compared to +22.2% for the MSCI AC World.
- The main contributors to relative performance in Q4 were the overweights in United Rentals, Salesforce.com and Partners Group (+51bps, +49bps, +40bps respectively). United Rentals rose +29% over the quarter after it reported better than expected Q3 revenues and EPS figures. The company's quarterly revenues were up +23.4% compared to the same quarter the previous year. Salesforce.com’s share price was up more than +29% after the company reported solid results beating consensus estimates. Salesforce revenues were up +11.3% on a year-on-year basis. Partners Group gained another +27% in Q4 after an already strong Q3, as the company confirmed improving conditions in terms of fundraising, valuations and transactions in H2 2023.
- The main performance detractors over Q4 were the overweights in Aon, Solaredge and Haleon (-30bps, -24bps and -23bps respectively). Aon lost -10% over Q4 2023 despite reporting results ahead of expectations. The name fell however after announcing a USD 13.4bn cash-and-stock deal to buy NFP, a global professional services firm. The deal allows Aon to move into the faster growing middle market space and is expected to be accretive to adjusted EPS by 2027 and beyond. Solaredge’s share price was down -28% as the company announced weak guidance given the challenging general market dynamics for the solar panels industry and specific unfavourable inventory trends related to its products. Haleon lost -1.5% in Q4 underperforming the overall Consumer Staples sector. The company reported Q3 volumes that came below expectations, margins were nevertheless ahead, and the full year guidance was reiterated.

Portfolio Activity and ESG

- Over Q4, the team sold the remaining position in Plug Power after the company lowered its gross margin guidance given elevated ramp-up costs. While the company generates revenues in line with its ambitious growth plan, the execution is more costly than estimated. Zebra Technologies was also sold on risks of further lackluster reported and guided revenues in their Q3 earnings release. The team decided to exit the position in Bloom Energy given risks of lower realized equipment pricing and considerable need for revenue and margin accleration in H2 to meet guidance. The team exited the remaining position in UnitedHealth given concerns over the repeatability of its high Cash Flow Return on Investment level (CFROI®, Source: Credit Suisse HOLT) in 2022 and uncertainties around the sustainability of the growth of its procedure business segment. The company could face regulatory headwinds that will become more visible during the US election campaigns in 2024. The position in Merck was exited after its potential blockbuster drug Evobrutinib surpringly failed Phase III clinical trials, negatively impacting the growth expectations of its pharma business.
- On the other hand, a position in Amazon was initiated. The company’s CFROI® is expected to recover to 2021 levels in 2023. Going forward, its CFROI® level is expected to be supported by margins expansions from growth in higher margins business

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segments (AWS and advertising). A position in Caterpillar was also initiated and financed by the reduction of Deere which reported record results for Q3 2023, but warned about the agriculture cycle turning lower in 2024. Caterpillar offers more CFROI® upside, with the construction industry expected to do better than agriculture. Finally, the team bought a position in Inditex on ongoing attractive growth and execution with a CFROI® again forecasted above 10% for 2023 and expected to grow to 15% over time.

- ESG considerations are fully integrated in each step of the fundamental investment process with a focus on a lower carbon footprint objective. At the end of December 2023, the portfolio had a AA ESG rating with an ESG quality score of 7.4, versus a A rating and 6.8 score for the MSCI AC World (ratings based on MSCI ESG Research). The portfolio's weighted average carbon intensity is significantly lower than its benchmark's with 14.1 tons CO_2/$mn sales vs 128.8 tons for the MSCI AC World index.

Outlook

- Global equity markets finished 2023 on a strongly positive note, despite some signs of growth slowing, the banking sector fallouts, wars in the Middle East and Ukraine, and still elevated bond yields. US and European equities have regained all of their 2022 drawdown and are trading close to their respective end-2021 market highs. Investors have factored in a soft-landing scenario for the US with possible interest rate cuts going into 2024. Moreover, with the Covid overhang now largely reflected in corporate results and the normalization of interest rates and inflation levels in sight, this should provide a supportive environment for equities in 2024, and more specifically for longer duration assets: quality companies with strong future cash flow streams.
- As valuation levels currently trade around long-term averages, earnings growth is expected to be the main market driver for 2024, after a low base of 0% growth in 2023. 2024 could thus offer a more favourable environment for active fund managers, as investors turn back towards fundamentally driven performance sources, which could lead to a catch-up of some of the lagging parts of the market.
- In this context, the Global Equity strategy should be well positioned to weather 2024 market conditions as it continues to focus on sustainable value creation and visible earnings growth with the bottom-up selection of companies with strong fundamentals and secular growth opportunities.

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