UBAM - GLOBAL EQUITY

Quarterly Comment

Marketing Communication

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Market Comment

- Over Q2 2023, global equity markets delivered strong results with the MSCI AC World up +6.2%. Japanese equities gained +14.2%, US equities +8.3%, Emerging Market equities +2.3%, Swiss Equities +2.2% and European equities +0.9%.
- In June, inflation figures remained resilient which led central banks to keep a hawkish stance. In the US, while the yearly headline inflation trend was down from +4.9% to +4.0%, core inflation only decreased moderately from +5.5% to +5.3% y/y and the 2023 outlook for core PCE was revised up from +3.6% to +3.9%. Key rates did not change, but Chairman Powell mentioned potential further hikes in the coming months – though at a slower pace. In the Eurozone, the outlook on inflation was revised up for the next 3 years, especially for core inflation from +4.6% to +5.1% for 2023. Key rates increased by +25bps as expected and the ECB mentioned that rates should be brought to sufficiently restrictive levels to meet the 2% inflation target indicating further hikes. Business sentiment weakened further with the US Manufacturing PMI decreasing from 48.4 in May to 46.3 in June. The Eurozone Manufacturing PMI also declined from 44.8 to 43.6.
- Over the quarter, EPS growth projections for global equities remained steady at 0% for 2023 and declined slightly to around 10% for 2024. Global equities' 12m forward PE increased to 16.2x, just above the long-term average, but with big differences across sectors and regions. US equities are now trading at an all-time high premium versus global equities after the re-rating of growth stocks and mega caps.
- During Q2, IT was the major contributor to the MSCI AC World's performance. Consumer Discretionary and Financials sectors contributed as well whereas Materials detracted slightly. Top contributing names over the period were again Apple, Microsoft and Nvidia while AbbVie, Tencent and Alibaba were at the bottom. Quality and Growth were the best performing investment styles over the quarter, while Momentum and Value styles underperformed the broader MSCI AC World index.

All performance figures are given gross of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Performance Review

- UBAM - Global Equity delivered +6.5% in gross performance over the second quarter of the year vs +6.2% for the MSCI AC World. The currency effect was the main contributor to relative performance with +68bps, namely the absence of exposure to Japan and the overweight in European developed markets. Sector allocation had a slight positive contribution as well with +7bps, particularly the absence of exposure to Materials, Utilities and Real Estate. On the other hand, stock selection, especially in the IT and Consumer Discretionary sectors, detracted -44bps from relative performance. YTD, the fund is up +10.8% compared to +13.9% for the MSCI AC World.
- The main contributors to relative performance in Q2 were the overweights in Eli Lilly, United Rentals and Ashtead Group (+26bps, +17bps, +14bps respectively). Eli Lilly appreciated + 26.2% in Q2. The company's shares climbed after reporting better than expected Q1 results and after clinical data from a late-stage trial for its experimental drug for Alzheimer showed better efficiency in slowing the disease than anticipated. United Rentals was up +13.0%, benefitting from the bullish near-term outlook for machinery and building products stocks over the month of June. Ashtead Group gained +9.8%. The company is a faster growing competitor to United Rentals and benefitted from the same trend.
- The main performance detractors over Q2 were the overweight in Thermo Fisher, the underweight in Nvidia and the absence of exposure to Amazon (-55bps, -39bps and -31bps respectively). Thermo Fisher lost -9.4% in Q2 as the company suffered from ongoing weak sentiment driven by weakness of life science demand and COVID overhang. Underlying business is guided for growth, but the net result for the year may be an unchanged revenue base, before numbers pick up again to 8% growth in 2024. Nvidia gained +52.3% in Q2, its shares jumped in May after reporting immediate benefits from AI related sales and orders for their Graphic Processor Units (GPUs), which are used for training AI models. The company's CFROI® (Cash Flow Return on Investment. Source: Credit Suisse HOLT) is forecasted to improve significantly, however, it has a cyclical past, where just a year ago a 1bn writedown on inventories was necessary and the shares dropped more than 60% at one point during 2022. Amazon was up +26.2% in Q2. The shares rerated on stabilizing earnings estimates, while rising expectations for Amazon Web Services (AWS) growth recovery and the perception of long-term AI tailwinds have driven outperformance.

Portfolio Activity and ESG

- Over Q2, the team initiated a position in Cadence, one of the leaders on the global chip design market. While its largest competitor, Synopsis, delivers slightly better growth rates, Cadence offers better margins and is more of an Electronic Design Automation (EDA) pure player with better management. These companies have historically grown their revenues even in times of semiconductors' cycle downturns. The team also initiated a position in Porsche, as its limited volume growth (mid-single digit) and strong pricing (mid-single digit) strategy should lead to a better mix with higher margins. While the company lagged the luxury rally since February, 9% sales growth and margin improvements from 24% to 26% in 2023 should lead to an improvement of its CFROI® from below 10% to 12% in 2023 and 14% in the next years. Porsche is rated A by MSCI ESG Research compared to B for the non-operating Porsche Automobil Holding. A position in Quanta Services, the maintenance and development supporter for the utilities sector, was bought on improving CFROI® towards 10% in 2023 and 11-12% beyond.

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The expected growth rates of 9-11% for the near term and 6-7% for the longer term are well supported by upgrades of grids and the gradual change towards generation via renewables. The company upside and valuation in HOLT looks reasonable at 20x. The existing position in Google was increased. The company's CFROI® forecast is maintained around 15%, and the promising integration of AI into products should be beneficial for achieving and maintaining more than 10% revenue growth. The team bought a position in Meta. While its CFROI® stays below 10%, accelerating double digit revenue growth, AI benefits (advertising, content, own AI chip design) and ongoing cost discipline offer an attractive opportunity with the stock trading at 15x, way below multiples seen for peers. Infineon was also added to the portfolio on strong EPS upgrades and recent weakness in the stock's performance leading to a de-rating to 12x EPS. The semiconductor cycle appears to be advanced but is not hurting industrial and automotive demand. The company offers 10% sales CAGR, but still has high capex spending. It's CFROI® should improve from 9% to 11% in the next years, after 4-6% historically. Finally, a position in Nvidia was initiated given the significant AI-related boost on sales, margins and earnings. These new additions were financed by reducing the positions in Financials, Diageo and Exxon Mobil.

- 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 June 2023, the portfolio had a AA ESG rating with an ESG quality score of 7.3, 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 26.7 tons CO_2/\$mn sales vs 139.1 tons for the MSCI AC World index.

Outlook

- The current context of slowing producer and consumer sentiment has put pressure on global corporate earnings for 2023 and while GDP forecasts are pointing to a growth recovery later in 2023 and for 2024, manufacturing PMIs are weakening, leading to some uncertainties for the remainder of the year.
- Within this context, the Global Equity strategy is well positioned. It focuses on active stock selection of value creative companies demonstrating a visible earnings outlook. Moreover, the strategy is exposed to structural growth trends. This should be supportive for the expected growth recovery in 2024.

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