COMMENTARY

Henderson EuroTrust

June 2022 Marketing Communication

Fund Manager Name

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Macro backdrop

The macroeconomic narrative started to change in June; the month started with lots of discussion of rising bond yields and inflationary pressure and then mid-month bond yields seemed to reach a near-term peak and have declined since. This stalling in bond yield progression brought some relief for growth/quality equities and there are a few commentators now suggesting that we may have reached the peak for interest rate expectations this cycle. The other dynamic this month was further evidence of the weakening environment for consumption. We saw a number of warnings from businesses exposed to consumer discretionary spending, especially in the US. Market valuations now seem to suggest that a recession is likely and sentiment (investor, consumer and business) has taken a big shift down.

Trust performance and activity

After the extreme value outperformance that we witnessed in May, June was better for growth stocks and Eurotrust outperformed the sharp index decline. Given the increasingly challenging macro environment, it is unsurprising to report that sectors exposed to discretionary consumer spending such as autos and retail, and traditionally cyclical sectors such as banks, energy and materials, suffered. We also saw weak performance from information technology, led by a sharp sell-off in the cyclical semiconductor sub-sector.

Better performing sectors included health care, consumer services and consumer staples. This kind of environment suited our holdings since we have an overweight position to quality, growth stocks and an underweight position to the value style. We also have an underweight position to information technology stocks.

June was a quiet month for stock-specific news flow (there were no results announcements for example) and our winners and losers have largely followed the pattern of the sectors described above. Our best performing positions were Novo Nordisk, KPN and Munich Re, and our worst performing positions were Arkema, Bawag and CNHI.

Trading activity was limited in June. We made some small rebalancing trades by reducing Stellantis and CNHI while adding to positions in Sartorius and Safran. We used market weakness towards the end of the month to add to some of our core positions, which brought up leverage by 1-2%, and we initiated one new position in BE Semiconductor (Besi). Besi is a high quality, highly cyclical semiconductor equipment company which historically has seen 60% gross profit margins and a high return on invested capital (ROIC). Its shares had fallen by over 50% since their peak in January due to concerns over the cycle.[1] We saw this as a solid opportunity to start to increase our semiconductor exposure via one of the best companies in the sector (the other being ASML, which we already own). People often confuse cyclicality with 'value' or 'low-quality' and Besi is a cyclical but well-managed business with well-entrenched oligopolistic/monopolistic market positions in a structural growth sector.

Outlook/strategy

We will continue to retain balance in our exposures by considering two types of business for investment; those where we see the potential for high and sustainable returns that we think are undervalued by the market and those companies where we can see a material improvement in medium-term business prospects.

[1]Source: Bloomberg as at 30 June 2022

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Glossary

Bond yield - The level of income on a security, typically expressed as a percentage rate. For a bond, this is calculated as the coupon payment divided by the current bond price. Lower bond yields means higher bond prices.

Inflation - The rate at which the prices of goods and services are rising in an economy. The CPI and RPI are two common measures.

Cyclical - Companies that sell discretionary consumer items, such as cars, or industries highly sensitive to changes in the economy, such as miners. The prices of equities and bonds issued by cyclical companies tend to be strongly affected by ups and downs in the overall economy, when compared to non-cyclical companies.

Growth investing - Growth investors search for companies they believe have strong growth potential. Their earnings are expected to grow at an above-average rate compared to the rest of the market, and therefore there is an expectation that their share prices will increase in value.

Gross profit margin - Gross profit margin is a metric analysts use to assess a company's financial health by calculating the amount of money left over from product sales after subtracting the cost of goods sold (COGS).

Return on invested capital (ROIC) - Return on invested capital (ROIC) is a calculation used to assess a company's efficiency at allocating the capital under its control to profitable investments.

Quality investing – Quality investing is an investment strategy based on a set of clearly defined fundamental criteria that seeks to identify companies with outstanding quality characteristics. The quality assessment is made based on soft (e.g. management credibility) and hard criteria (e.g. balance sheet stability).

Value investing - Value investors search for companies that they believe are undervalued by the market, and therefore expect their share price to increase. One of the favoured techniques is to buy companies with low price to earnings (P/E) ratios.

Valuation metrics - Metrics used to gauge a company's performance, financial health and expectations for future earnings e.g. price to earnings (P/E) ratio and return on equity (ROE).

Janus Henderson
INVESTORS