

Henderson European Focus Trust

July 2022

Marketing Communication

Fund Manager Name

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Macro backdrop

European equities rose 7.5% in July which brought the damage so far this year back to under 10%. The dominant narrative was the US Federal Reserve (Fed) pivot on its narrative around interest rates, and yield curves inverting as the bond market priced in both a recession and the anticipation of incrementally dovish rhetoric from central bankers in their attempt to tackle runaway inflation. Investors, still imbued with a strong muscle memory for what has worked over the last decade, were triggered to buy growth-style equities and avoid value-style equities. Investors bought back in to quality growth companies - for whom multiple compression from higher interest rates was no longer a worry - and the likes of banks were discarded for good measure. Technology stocks outperformed the market with the sector up over 13%.¹

Trust performance and activity

We further added to the Trust's positions in TotalEnergies and Safran (the latter a position we had initiated in June) and trimmed the position in Novo Nordisk (although it still remains a large holding). We selectively added to semiconductor-exposed positions and other short-cycle companies where we felt the share price trough could be near following dramatic declines in anticipation of a recession.

Outlook/strategy

It is notable that the Trust's sector underweight positions were the biggest determinants of outperformance in July. We lost alpha to the technology rally in which we did not fully participate, but this was more than offset by our continued avoidance of banks and telecoms. It is also noteworthy that these sector positions have been relatively consistent for us over time and could be regarded as almost structural - at least as much as is possible for a style-agnostic, valuation-conscious strategy. We tend to find these sectors unfairly priced; technology due to lofty absolute multiples relative to what we see as their economic prospects, banks because we see them as generally poor-quality businesses with an unrivalled history of giving investors a hard time, and telecoms for similar reasons but with added capital intensity.

¹Source: Bloomberg as at 31st July 2022

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Glossary

Alpha - Alpha (α) is a term used in investing to describe an investment strategy's ability to beat the market, or its "edge." Alpha is thus also often referred to as "excess return" or "abnormal rate of return," which refers to the idea that markets are efficient, and so there is no way to systematically earn returns that exceed the broad market as a whole.

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.

Monetary policy - The policies of a central bank, aimed at influencing the level of inflation and growth in an economy. It includes controlling interest rates and the supply of money. Monetary stimulus refers to a central bank increasing the supply of money and lowering borrowing costs. Monetary tightening refers to central bank activity aimed at curbing inflation and slowing down growth in the economy by raising interest rates and reducing the supply of money.

Quantitative tightening - Quantitative tightening (QT) is a contractionary monetary policy tool applied by central banks to decrease the amount of liquidity or money supply in the economy.

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).

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.

Recession - A recession is a significant, widespread, and prolonged downturn in economic activity. Because recessions often last six months or more, one popular rule of thumb is that two consecutive quarters of decline in a country's Gross Domestic Product (GDP) constitute a recession.

Yield curve - A graph that plots the yields of similar quality bonds against their maturities. In a normal/upward sloping yield curve, longer maturity bond yields are higher than short-term bond yields. A yield curve can signal market expectations about a country's economic direction.

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