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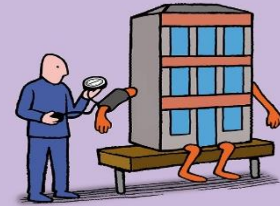
ASSET MANAGEMENT

EUROPEAN INCOME FUND

Investment Commentary

Q2 2024



Market review

The strongest equity returns were to be found in LargeCap during the opening half of 2024. SmallCap underperformed its larger peer by a 4% over the 6 months to 30 June, while MidCap did not fare much better. Prio to the current period, Pan-European SmallCap had never underperformed LargeCap by more than 2 consecutive years in over 25 years. The asset class is now on track for its 4th year of underperformance.

Conditions in the equity markets continued to be dominated by two main themes: stickier-than-expected inflation and the ongoing domination of the large technology stocks in the US. In both the US and parts of Europe, continued to be a source of concern for policymakers. This had a negative impact on smaller companies which are more interest rate sensitive compared to their larger peers.

LargeCap technology stocks – and in particular anything "A.I" related – performed strongly. Nvidia, continued its heady triple-digit ascent (although the Magnificent Seven did begin to show some signs of bifurcation) while Europe's "GRANOLAS" also continued to perform strongly.

Towards the end of the second quarter, political upheaval weighed on most parts of the equity markets. The UK faced an election and a change of government, while in France a snap election was called by Emmanuel Macron, which raised market volatility. In the US, the election bandwagons began to roll.

Portfolio

During the quarter, the NAV of the Sterling Share class declined by 1%, an underperformance of 0.3% versus the composite benchmark.

The strongest contribution during the quarter came from **Atea**, the provider of IT solutions, which

NCAB, the full-service supplier of printed circuit boards, outperformed after demand stabilised, and management indicated a gradual improvement over the coming quarters with higher order intake and revenues. **AAK**, the producer of high-value added vegetable oils and fats, rose as analysts lifted their estimates post a strong Q1 report.

The weakest contribution came from **Moncler**, the Italian luxury outerwear brand, which retreated on weakening demand across the luxury sector. **Brenntag**, the global distributor of bulk and speciality chemicals, reported a challenging Q1 citing inventory de-stocking and pockets of price pressure. **Azelis**, the specialty chemicals distributor, was impacted by a large secondary placing as well as soft operational performance in Q1.

Outlook

At the end of 2023 we suggested that the conditions might be ripening for smaller companies to emerge from their multi-year hibernation. This is yet to happen. How does this set us for the next six months?

Despite inflation remaining "higher for longer", there were clear signs of cooling towards the end of June. Eurozone inflation slowed to 2.5% in June, allowing the European Central Bank to begin its rate cutting programme. Data in the US has also become more supportive. On a June annualised basis core CPI in the US was below 1%, while the three-month average was only a whisker above 2%. Most reassuringly for Growth investors, such as ourselves, CPI shelter inflation (the average cost of housing in the US) plummeted to 2%. Not so long ago it was above 8%. The market reaction to this data? Futures priced in a 91% probability of a rate cut in September (up from 55%); Treasuries rallied and the yield curve steepened; and the technology behemoths fell (Nvidia by almost 6%), while SmallCap gained.

With macro data becoming more supportive of smaller company investing, it is worth ending with a point on valuation. European ex-UK SMidCap looks increasingly compelling from a valuation perspective, trading on a 9% P/E discount to LargeCap. This is higher than during the GFC of 2008! On a long-term view, now may be as good a time as any for dipping a toe back into smaller company waters.

Latest reports

- Deep Dive #11: Project Net Zero Carbon 2023
- Deep Dive #10: The Built Environment
- PRI 2023 – Assessment Report
- Proxy Voting Summary 2023

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