

July 2022 | Rothschild & Co Asset Management Europe



Fund update

R-co Conviction Equity Value Euro



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Market evolution for the month

Global indices fell sharply in June, with the spectre of recession adding to the rise in interest rates. The Eurostoxx with dividends reinvested was down by 9.4%⁽¹⁾ over the period. June was a difficult month for all global markets, bringing to a close a particularly damaging half-year in terms of performance. European equities recorded their worst half-year since 2008, while US equities suffered their biggest fall in over 50 years.

Concerns about growth prospects have accelerated the downward trend. Eurozone PMIs⁽²⁾ have deteriorated with the composite⁽³⁾ falling to 51.9 in June (vs. consensus 54)⁽¹⁾. These concerns are supported by inflation figures that continue to be surprisingly high and put central banks on alert. These data show a rise of more than 8% in Europe for the month of May, while the new acceleration of US inflation reached 8.6% compared to 8.3% in April⁽¹⁾. In this context, the Fed decided to raise its rates by 75 basis points (bps), the largest increase since 1994⁽⁴⁾. At the same time, the ECB announced on June 9th the beginning of its monetary policy normalisation with a first increase of 25 bps for July⁽⁵⁾, while putting an end to its asset repurchase programme. In China, on the other hand, an improvement in the economic situation could be seen. The gradual lifting of zero-covid policy restrictions is leading to a slight improvement in activity data, although it still remains at relatively low levels. The Caixin composite PMI data stood at 42.2 in June, compared with 37.2 in May⁽¹⁾.

As for the fixed income market, after a sharp rise in the first part of the month, concerns about the cycle weighed on the level of rates in the second part. In the end, the US 10-year rate rose by 20 bps, closing the month at 3.01% after having reached 3.47% on June 14th; while in Europe, the Bund⁽⁶⁾ stood at 1.33% (after having reached a high of 1.77%)⁽¹⁾.

Following this sharp correction in June, the cyclical sectors suffered particularly badly. The commodities sector, which had held up well since the beginning of the year, was the most affected. Other sectors that declined include real estate, leisure & travel, and the automotive sector. Conversely, defensive sectors clearly outperformed, with consumer goods, food retailing and telecoms performing particularly well.

This market environment has favoured the Growth investment style, which has outperformed, posting a decline of 7.7% while the Value investment style has declined by 11.0% over the month⁽¹⁾. Since the beginning of the year, the advantage remains in favour of Value, which has outperformed Growth by 10.7%⁽¹⁾.

At the micro-economic level, companies are not yet seeing these signs of a slowdown in economic activity reflected in their results. Analysts therefore remain optimistic, and their forecasts remain particularly high as the half-year results season begins, with earnings growth in Europe expected to reach 13.3% in 2022 and 5.4% in 2023⁽⁷⁾.

(1) Source: Bloomberg, 30/06/2022

(2) PMI (Purchasing Manager's Index) is an indicator that reflects the confidence of purchasing managers in an industry. Above 50, it expresses an expansion of activity, below 50, a contraction.

(3) Index of manufacturing and service sectors.

(4) Source: Federal Open Market Committee (FOMC), June 15th, 2022.

(5) Source: Extract from Christine Lagarde's speech, June 9th, 2022.

(6) Bond issued on behalf of the German government, equivalent to the French OAT. The Bund interest rate, which has a maturity of 10 years, is considered the benchmark for the German market but also for European markets.

(7) Source : Goldman Sachs, European Weekly Kickstart, 27/06/2022.

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Fund Positioning & Outlook

After a strong outperformance in May, R-co Conviction Equity Value Euro lost 11.8% during the month of June, underperforming its benchmark by 2.4%⁽⁸⁾, bringing its year-to-date outperformance to 2.35%⁽⁹⁾. One third of the underperformance in June was due to an allocation effect, notably the overweight in the banking sector and the underweight in the consumer goods sector. The remaining part is explained by the underperformance of some cyclical stocks that have particularly suffered from the context of macroeconomic fears, notably Arcelor, Saint Gobain, Alstom, Faurecia and Atos.

Investors are now taking into account the increasing probability of a recession. With the latest inflation figures and leading indicators starting to turn, this scenario is becoming increasingly plausible. To limit the impact, governments would need to target support to poorer households to get through the rising inflation (with the better-off able to use accumulated savings), and a fall in commodity prices would need to materialise in the coming months. The markets seem to be giving less and less credence to this possibility. According to a study by Goldman Sachs, a cyclical recession such as the one we are facing is generally characterised by a 30% drop in indices and lasts for two years on average. The fall of almost 20% since the beginning of the year is therefore rapid and implicitly reflects a decline in earnings per share (EPS) of around 15%. This would leave a further decline of around 10% if we believe in this recession scenario. This last “leg down” could come when analysts adjust downwards their forecasts, thus acknowledging the economic slowdown if it occurs.

In response to this increased risk of recession, we have increased the weight of the defensive pillar of the fund from 18% at the end of May to 28% at the end of June. We have therefore limited our exposure to cyclical sectors, whose performance could be impacted by a fall in EPS that could occur in the coming months. However, we remain convinced of the quality of the stocks we hold in these sectors, and we will reposition ourselves in these stocks once the market has incorporated a growth outlook in line with the deteriorating macroeconomic situation.

This resulted in a reduction in the weighting of the construction sector by almost 3%, via the reduction of our positions in Saint Gobain and Eiffage; and a reduction in the weighting of the media sector by 1%, via the selling of our position in Atresmedia (Spanish television channel). We also reduced the weighting of the automotive sector by almost 2%, by reducing the weighting of Stellantis and Mercedes in the portfolio and reduced the weighting of the leisure & travel sector by selling our position in Accor and reducing our position in IAG.

At the same time, we strengthened defensive stocks, mainly in the health sector (Sanofi), food/beverage (Danone), utilities (EDP and Veolia Environnement), telecoms (KPN, Orange and Deutsche Telekom) and retail (Carrefour).

We also reinforced TotalEnergies in the oil sector. Indeed, the energy sector seems to us to have defensive properties in the current geopolitical context. The supply/demand imbalance remains significant, and the valuations of companies in the sector do not reflect the current level of oil prices. Even if demand in Europe and North America declines, the recovery in Chinese demand in the second half of the year and the various supply disruptions should keep oil at high levels and allow the sector to continue to outperform.

In addition, we have increased our position in Arcelor. The stock should benefit from the outlook for recovery in China and has suffered greatly from recession fears despite having a very strong balance sheet.

Finally, we have maintained our marked overweight in the banking sector. Indeed, the decorrelation between the level of interest rates and the sector's performance does not seem justified to us. The sector is performing in line with the market, as investors are currently only taking into account the rise in risk costs and the fall in credit volumes. However, the sector has a high solvency ratio and provisions made during the Covid-19 crisis that have not been used for the most part. Moreover, the sector will benefit from a positive base effect on the remuneration of deposits with the ECB. The fact that rates are moving back into positive territory will therefore be a source of income for the sector, whereas it used to cost it in the past. Ultimately, the rise in rates will remain an extremely positive element for banks' interest margins, given the sensitivity of the sector's results to interest rates.

Completed on 7 July 2022

(8) Benchmark: Euro Stoxx ® NR.

(9) Source: Rothschild & Co Asset Management Europe, 30/06/2022.

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Performance	Since the beginning of 2022	2021	2020	2019	2018	2017	Since inception	1 year volatility
R-co Conviction Equity Value Euro C EUR	-16.20 %	26.30%	-9.85%	17.64%	-18.01%	14.74%	79.22 %	21.44 %
Euro Stoxx® NR ⁽¹⁾	-18.55 %	22.67%	0.25%	26.11%	-12.72%	12.55%	71.91 %	18.07 %

(1) Benchmark.

Sources: Rothschild & Co Asset Management Europe, 30/06/2022.



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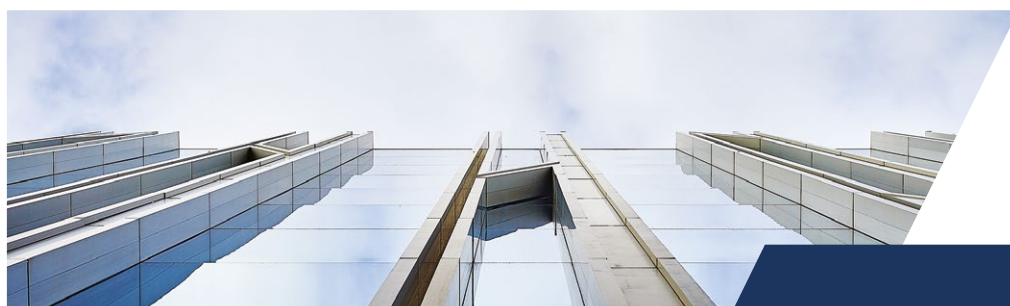
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