Rothschild & Co
Asset Management

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Fund update
R-co Conviction Equity Value Euro

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July market trends

After declining steeply in the first half of the year, Western markets rallied in July, with the EuroStoxx with reinvested dividends gaining 7.3%[1] (its steepest monthly gain since November 2020), the S&P 500 (+9.2%[1] in USD), and the Nasdaq (+12.4%[1] in USD). Uncertainties remain high, inflation is having a hard time peaking, and macroeconomic data have worsened. Nevertheless, investors – encouraged by a better-than-expected second-quarter (2Q) reporting season – seem to believe that central banks will be unable to stick to their restrictive monetary policies for very long and will have to allow the economy to breathe some.

Q2 euro zone GDP expanded by 0.7%[1], beating the +0.2% forecasts[1]. However, PMI[2] figures were a negative surprise, declining across-the-board in all countries and sectors, while consumer confidence fell to a low since 2009 (at -27[1] in July). At below 50 (i.e., 49.4[1] for the composite index), these PMI figures confirm the possibility of a recession even as inflation continues to set all-time records, at +8.9%[1] in July (up from +8.3%[1] in June). It was this latter figure that caused the ECB to raise its key rates by 50 basis points[3] (bp) although it had flagged a mere 25bp hike the previous month. Meanwhile, it announced an anti-fragmentation tool, called the "TPI"[4].

Chinese GDP naturally stalled in Q2 (at +0.4% vs. +4.8% in Q1)[1], but the reopening of the economy unleashed manufacturing output and retail sales in July. Even so, PMI figures are approaching 50 (50.4 in July vs. 51.7 in June)[1], reflecting the uncertainties caused by keeping the "zero-Covid" policy in place, despite a new fiscal stimulus *via* the issuance of $200bn in special bonds.

The US entered a technical recession with a second consecutive quarter of GDP decline (-0.9%[1] q/q in Q2 after -1.6%[1] in Q1), while there were increasing signs of economic slowdown, including lower ISM and consumer confidence indices and a further weakening in real-estate market data. Inflation once again broke a 41-year record at +9.1%[1], which pushed the Fed into a second 75bp rate hike[5] after June, raising the Fed Funds target range to 2.25-2.5%[5].

On the fixed-income front, long bond yields declined. The 10-year US yield fell from 3.01% to 2.65%[1], and the Bund from 1.33% to 0.81%[1]. This naturally drove outperformance by long-duration sectors on the month (technology +14.1%[1] and consumer goods +13.9%[1]), and penalised financial sectors (banks +0%[1] and insurance -0.3%[1]). This interest-rate environment therefore provided a big boost to growth stocks[6], which were up by 13.3% [1] on the month (vs. +3.0%[1] by value stocks[7]), thus taking value's year-to-date outperformance vs. growth to +3.1%[1].

(1) Source: Bloomberg, 31 July 2022.

(2) PMI: The Purchasing Manager's Index is an indicator reflecting the confidence of purchasing managers in a particular economic sector. When it is above 50 it points to an expansion in activity; and below 50, to a contraction. The composite index encompasses both manufacturing and services sectors.

(3) Source: European Central Bank meeting of 21 July 2022.

(4) TPI: The Transmission Protection Instrument will, under certain conditions, allow the ECB to buy financial securities, particularly government and corporate bonds issued in countries experiencing a worsening in their financing conditions.

(5) Source: Fed, 27 July 2022.

(6) Growth style: Growth investors focus mainly on potential earnings growth, while hoping that growth in revenues and earnings will be greater than that of its sector or the market average.

(7) Value strategy: this consists of seeking out companies that are undervalued by the market at a given time, i.e., companies whose market valuations are lower than they should be with regard to their earnings and the value of their assets. Value investors pick stocks having low price/book values or high dividend yields.

On the microeconomic front, Stoxx 600 companies' second-quarter earnings reporting season turned out better than expected, with revenues 4.0%[8] over the consensus, but earnings per share (EPS) just 2.6% above[9], in line with the worsening in margins expected over the past several months. Meanwhile, the tone was less optimistic on guidance[10], with a high level of uncertainty that is limiting visibility, and more and more talk of an economic slowdown (10). Downward EPS revisions are beginning to emerge, albeit with increases of 16.3% still forecast for 2022 (+4.2% ex commodities) and +3.9% for 2024 (+10.8% ex commodities)[11].

Fund performance & positioning

R-co Conviction Equity Value Euro C EUR gained +3.8%[12] in July, underperforming its benchmark (the Euro Stoxx® NR) by 3.5%[13] on the month (and by 0.4%[13] on the year to date). Two thirds of this underperformance was due to allocation, as the fund was hit by both the rally by growth stocks (techs and consumer goods), and by the underperformance of our heaviest weightings (banks and energy). The rest is due to the dip on the month of shares that had fared especially well on the year to date, including CaixaBank (+27.3%[13]) and Orange (+9.9%[13]).

The market rally picked up speed after the Fed's latest meeting, when Jerome Powell raised hopes of a shift in monetary policy by the US central bank when he implied (as had the ECB's Christine Lagarde and the Bank of England's Andrew Bailey) that future rate hikes were not pre-ordained and would be data-dependent when the time came. The markets interpreted this as the pivot point they had expected, resulting in the aforementioned receding in long bond yields.

However, we feel this expectation of a shift in monetary policies looks premature for several reasons: i/ there has been no change in central banks' underlying guidance, i.e., that their priority is to rein in inflation, even if that means undermining economic growth; ii/ falling prices of energy (with the notable exception of natural gas in Europe) and agricultural commodities[13] should normally rein in inflation soon, but its historically high level is likely to keep central banks hawkish for some time to come before they approach their +2% targets; iii/ job data remain very solid in both Europe and the US, which makes central banks more comfortable in the economy's ability to handle rate hikes; and iv/ uncertainty remains very high and became even more so during the month, particular in Europe, where Vladimir Putin demonstrated *via* the Nord Stream pipeline[14], that he still holds the edge in negotiating clout for the coming months, thus keeping alive the threat of a European recession.

Meanwhile, the downward EPS revisions that are almost inevitable, are, in fact, still taking time to show up. We doubt the market will be able to transform the July rally[15] at this point into a true upward trend, at least until these revisions have begun.

We made no change to our portfolio's positioning, after buttressing its defensive pillar significantly (reminder: from 18% to 28%)[12]. As cyclicals' relative valuation vs. defensives is at an all-time low, we have chosen to go no further in reducing the portfolio's cyclical exposure.

Meanwhile, we have maintained our overweightings of energy (~5.0%[12]) and banks (~10%[12]), considering their underperformance on the month to be temporary, while also remaining optimistic on EPS trends in both sectors, even in the event of a moderate economic recession in the euro zone. For one thing, oil prices may have receded since June, but analysts have never built excessive assumptions into their Brent models, much less their natural gas models. Cash generation is therefore likely to remain at all-time highs for the months to come, whereas we see very little downside EPS risk and valuations are still just as attractive. Moreover, banks' recent very strong releases reinforce our idea that higher interest rates are helping them restore growth in interest margins and leave some ability to absorb a possible increase in the cost of risk in the event of a decline in the macroeconomic environment. Moreover, like the energy sector, banks' valuations are still at low levels.

Completed on 5 August 2022

(8) Value strategy: this consists of seeking out companies that are undervalued by the market at a given time, i.e., companies whose market valuations are lower than they should be with regard to their earnings and the value of their assets. Value investors pick stocks having low price/book values or high dividend yields.

(9) Source: Exane, 1 August 2022.

(10) Source: Barclays Equity Market Review; Rally kept in check, 5 August 2022.

(11) Source: Goldman Sachs, European Weekly Kickstart, 29 July 2022.

(12) Source: Rothschild & Co Asset Management Europe, 31 July 2022.

(13) Source: Bloomberg, 31 July 2022.

(14) Nord Stream is a system of two gas pipelines connecting Russia to Germany under the Baltic Sea.

(15) Rally: The pronounced, but ephemeral speculative rise of a stock, a market or a type of investment amidst a downward market configuration.

Performance	Since the beginning of 2022	2021	2020	2019	2018	2017	Since inception [1]	1 year volatility
R-co Conviction Equity Value Euro C EUR	-13,05%	26,30%	-9,85%	17,64%	-18,01%	14,74%	85,95%	21,79%
Euro Stoxx ® NR[2]	-12,60%	22,67%	0,25%	26,11%	-12,72%	12,55%	84,46%	18,65%

(1) Inception date: 20/05/2005.
(2) Benchmark.
Sources: Rothschild & Co Asset Management Europe, 31/07/2022.

The level of risk of the UCITS is 6 (volatility of between 15% and 25%) and primarily reflects its positioning on the Eurozone equity markets. The historical data used to calculate this synthetic indicator may not be a reliable indicator of the UCITS' future risk profile. The risk category associated with the UCITS is not guaranteed and may shift upwards or downwards over time. A rating of 1 does not mean that the investment is "risk-free". The capital invested in the UCITS is not guaranteed. Other important risk factors, not adequately taken into account by the indicator: liquidity risk, impact of techniques such as derivatives. The occurrence of one of these risks may result in a decrease in the UCI's net asset value. For more information about the risk profile and its main contributors, please refer to the prospectus.

Any investment is always subject to risk. Before investing, each investor must ensure the jurisdictions in which the UCI is registered. The KIID, the full prospectus as well as the net asset value (NAV)/net inventory value (NIV) are available on our website: am.eu.rothschildandco.com

Disclaimer

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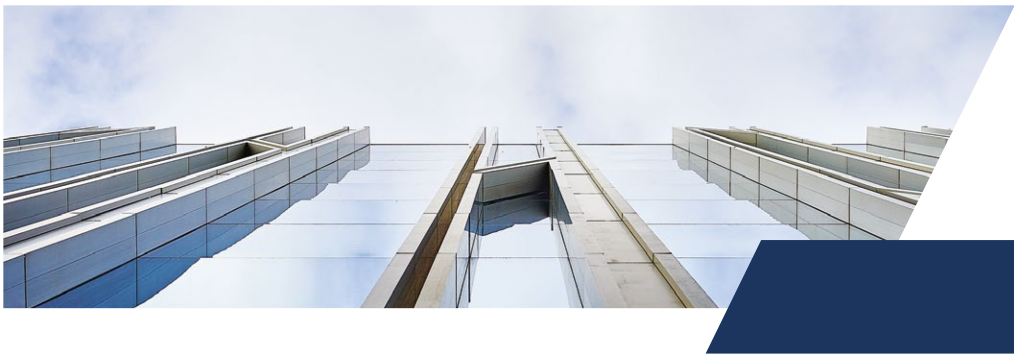

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