October 2022 | Rothschild & Co Asset Management Europe

Fund update
R-co Conviction Equity Value Euro

Anthony Bailly
European Equities
Fund Manager

Vincent Iméneuraët
European Equities
Fund Manager

Market trends

Financial markets continued to decline in September, as they had since the second half of August, against a backdrop of ongoing tightening in central bank monetary policies. The MSCI World fell by 6.9% and the S&P 500 by 6.8% (in dollars). Meanwhile, the EuroStoxx with dividends reinvested turned in its seventh monthly decline on the year, this time by 6.2%[1].

Inflation obviously remained the main topic, especially in Europe, where it crossed the 10% threshold (vs. 9.1% in August and forecasts of 9.7%)[1]. Driven by an especially poor number in Germany (10.9% vs. 8.8% in August)[1], inflation does indeed seem to be spreading throughout the economy, in spite of government measures to rein in energy prices. In fact, it has been so persistent that the ECB put through a 75 basis point (bps) rate hike (with its deposit rate now at 0.75%), thus matching its deeds to Christine Lagarde's hawkish words[2] since Jackson Hole. The ECB also raised its inflation forecasts (to 5.5% in 2023 and 2.3% in 2024)[3], and lowered its growth projections (to +0.9% for 2023, followed by a rebound to 1.9% in 2024)[3]. The Eurozone PMI[4] composite index fell for the fifth consecutive month, this time from 48.9 to 48.1[5]. Also in Europe, the BoE[6] did put through a 50 bps rate hike but was forced to postpone its balance-sheet reduction plan and restart its government bond buying programme after the market turmoil set off by Liz Truss's announcement of a debt-financed stimulus plan. Last but not least, at the gates of Europe, concerns remain over a possible escalation of the situation in Ukraine following the annexation referendums held late last month. The Ukrainian forces' recent counterattack and the ever more threatening line taken by Vladimir do not seem to point to a resolution any time soon to the conflict.

In the US, inflation did recede (to 8.3% in August vs. 8.5% in July and 8.1% forecast)[1], but core inflation picked back up (to 6.3% in August vs. 5.9% in July)[1], reviving market fears and undermining the narrative that inflation had already peaked. Job creations are still robust (315,000 vs. 298,000 forecast)[1], showing that the labour market is still tight and stoking fears that inflation will continue via a wage-price spiral. In reaction, and as expected, the Fed reiterated its determination to bring inflation to a head through a third consecutive 75 bps rate hike.

However, what wasn't expected was the Fed's hawkish line, with its forecasts of key rates that were beyond market expectations, at, respectively, 4.4% for the end of 2022 and 4.6% for the end of 2023.

(1) Source: Bloomberg – 30/09/2022.
(2) Monetary policy that seeks to reduce inflation or prevent inflation by raising interest rates?
(3) Source: European Central Bank – 30/09/2022.
(4) The PMI (Purchasing Manager's Index) is an indicator reflecting the confidence of purchasing managers in a sector of activity. Above 50, it expresses an expansion of activity, below 50, a contraction. The composite index includes the manufacturing and service sectors.
(5) Source: Bloomberg – 05/10/2022.
(6) Bank of England.
(7) Source: Fed meeting 21/09/2022.

In China, the economic recovery is taking its time and is being held back by the zero-Covid policy. Retail sales and manufacturing output expanded, respectively, by 5.4% and 4.2% year-on-year, but September PMI indicators fell short of expectations. The manufacturing indicator rose only slightly (from 49.4 to 50.1), while the non-manufacturing number actually fell (from 52.6 to 50.6), as did the Caixin (from 49.5 to 48.1)[8].

Interest rates rose especially sharply in September, driven mainly by real rates, and this contributed to a de-rating on the equity markets. The 10-year US yield rose by 64 bps (including 96 bps in real rates), the 10-year UK rate by 128 bps (147 bps in real rates), and the Bund[9] by 57bp (80 bps in real rates)[10]. These shifts also had a heavy impact on currencies, with sterling dropping by 1.5% vs. the euro and by 4% vs. the dollar[10], and with the Bank of Japan's first forex market intervention since the Asian crisis in 1998.

Bad news is also beginning to show up on the microeconomic level, with no fewer than 30 profit-warnings[11] in Europe in September. These have been caused by various factors, including weaker volumes (Fedex and Colruyt, for example), higher costs (Dow Chemical, AB Foods and Kion), and bottlenecks (Ocado and Telenor)[12]. The inflationary environment that has now lasted for several months is beginning to feed through directly and indirectly into companies' guidance. Earnings per share (EPS) forecasts for 2022 on the Stoxx 600 have been revised slightly lower (to +18.5% vs. 18.8% the previous month, and to +5.0% ex-commodities vs. 5.8%), while forecasts for 2023 have been raised marginally (to 3.3% vs. +2.9% and to +10.2% ex-commodities vs. +9.7%)[13]. This suggests an uneven landscape, something that company managers will probably confirm during third-quarter reporting season.

Fund performance & positioning

In this challenging market context, R-co Conviction Equity Value lost 6.8% on the month, almost as much as its benchmark[14] (-6.2%), thus shrinking its year-to-date outperformance to +0.7%[15]. While the fund's sector allocation provided a boost, particularly in its overweighting of banks (the month's top sector at -0.8%), it also took a hit from its stock-picking, with the marked decline of some of our stocks during the month including Faurecia (-21.9%), Alstom (-18,6%), and Carrefour (-14.6%)[16].

For the same reasons as in the two previous months – i.e., a further slide in soft data[17], stubborn inflation, and ongoing energy uncertainties in Europe – we have still not sought to ramp up the portfolio's cyclical profile. These factors continue to undermine the macroeconomic outlook, particularly in Europe, and we reiterate our cautious take on the economic environment for the weeks and months to come.

That being said, on a market that has just experienced its worst monthly performance and with a recession looking more likely than ever, cyclical stocks' relative valuations vs. defensives have not budged from the historic low they reached last month. For example, like telecoms (-11.2% in September)[16], some defensive sectors underperformed the market on the month, while others merely performed in line with it, such as Healthcare and Utilities (-6.8%)[16]. This reinforces our view that the market has already priced in a moderate recession. For the moment, we have held onto the more conservative stance we have taken on the fund since June. If PMI indices continue to worsen and if, as we expect, downward revisions in EPS forecasts come to pass, we will soon be tempted to reinvest in certain hard-hit cyclical stocks that offer attractive entry points on a medium- to long-term horizon.

With this in mind, we are keeping a close eye on the Autos sector. True, it once again underperformed the market (-7.7% on the month of September)[16], but its volumes are recovering rapidly as supply-chain issues are resolved. The sector's year-to-date underperformance (-25%)[16], the very poor outlook being priced into deeply discounted valuations, and key markets that offer considerable potential for rebound even in a recession – the US market has shrunk by 26% since May 2021 and the European market by 35% from its peak in August 2018[18] – suggest to us that the sector is close to bottoming out.

(8) Source: Bloomberg – 30/09/2022.
(9) Yield of the 10-year German bond.
(10) Source: Bloomberg - 01/10/2022.
(11) Warning declaration issued by a listed company to investors through a stock exchange. It warns investors that the profit of the company in the coming quarter will significantly decline when compared with that of the same quarter of previous year, or the company may even make a loss.
(12) Source: Exane, September summary - 03/10/2022.
(13) Source: Goldman Sachs Europe Weekly Kickstart – 23/09/2022.
(14) Benchmark: Euro Stoxx ® NR.
(15) Source: Bloomberg, Rothschild & Co Asset Management Europe – 30/09/2022.
(16) Source: Bloomberg – 30/09/2022.
(17) Hard data is defined as raw macroeconomic data that reflects real and past statistics (e.g. GDP figures), whereas soft data corresponds to data from surveys carried out on a recurring basis, which seek to have a prospective aspect and try to draw future trends by evaluating opinions or confidence levels, such as that of companies (PMI) or households.
(18) Source: WARD's Automotive Group, Exane - 01/10/2022.

Meanwhile, we still have a very constructive view of banks and energy for two reasons:

1. the two sectors' valuations are among the most attractive;
2. their earnings growth outlooks are still looking good, due to higher interest rates for banks and sustained high oil & gas prices (albeit with a recent dip) in the case of energy (see OPEC's[19] recent output cuts).

Meanwhile, in a geopolitical context that remains highly tense, energy continues to offer – for once, in our view – defensive features.

As for portfolio adjustments, we sought to diversify our banking exposure while continuing to overweight the sector by just as much. We did so by bringing Bankinter into the portfolio, due to its interest-rate sensitivity and the ability it has demonstrated in previous crises to limit its cost of risk. This helped us readjust our risk profile. We set up this position, among other things, by taking some profits on Caixabank (up by 44% on the year to date)[20], and by dialling back our bets on the Italian banks Intesa and Unicredit, which have thus far shrugged off the Italian election results. In addition, we added to our cyclical positions that were hit hardest during the month, including Saint-Gobain, Technip Energies, Faurecia and Alstom, in order to limit their dilution by buying into weakness that we felt was overdone. However, we have made only small moves so far.

Completed on 5 October 2022

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	-21.46%	26.30%	-9.85%	17.64%	-18.01%	14.74%	67.98%	22.35%
Euro Stoxx ® NR(2)	-22.16%	22.67%	0.25%	26.11%	-12.72%	12.55%	64.28%	19.22%

(1) Inception date: 20/05/2005.
(2) Benchmark.
Sources: Rothschild & Co Asset Management Europe, 30/09/2022.

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

(19) Organization of Petroleum Exporting Countries
(20) Source: Bloomberg – 30/09/2022

The figures quoted relate to the past months. Past performance is not a reliable indicator of future performance and is not constant over time.

Performance calculated in euros and net of dividends reinvested. The information contained in this document does not constitute investment advice, tax advice, a recommendation or investment advice from Rothschild & Co Asset Management Europe.

Allocations and distributions, both geographical and sectoral, are not fixed and may change over time, within the limits of the prospectus.

Disclaimer

Advertising, simplified and non-contractual document. The information, comments and analyses in this document are provided for information purposes only and should not be construed as an investment or tax advice, or as an investment recommendation from Rothschild & Co Asset Management Europe. The information/opinions/ data mentioned in this document considered legitimate and correct on the day of publication, in accordance with the economic and financial environment in place at that date, are subject to change at any time.

Although this document has been prepared with the greatest care from sources that Rothschild & Co Asset Management Europe believed to be reliable and in good faith, no representation or warranty, express or implied, is made as to information accuracy or completeness, which are indicative only and are subject to change without notice. Rothschild & Co Asset Management Europe has not independently verified the information contained in this document and cannot be held responsible for any errors, omissions or interpretations of the information contained in this document. This analysis is only valid at the time of writing of this report.

Furthermore, given the subjective nature of certain analyses, we draw your attention to the fact that any information, projections, estimates, anticipations, assumptions and/or opinions are not necessarily put into practice by the management teams of Rothschild & Co Asset Management Europe, or its affiliates, who act according to their own convictions. Certain forward-looking statements are prepared on the basis of certain assumptions, which are likely to differ either partially or totally from reality. Any hypothetical estimates are, by their nature, speculative and it is possible that some, if not all, of the assumptions relating to these hypothetical illustrations may not materialise or may differ significatively from current determinations.

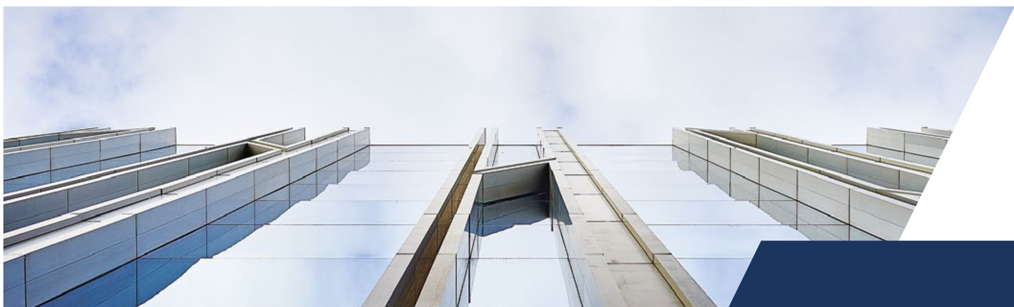
R-co Conviction Equity Value Euro is a sub-fund of the Société d'Investissement à Capital Variable "R-Co" incorporated under French law, whose registered office is 29 avenue de Messine - 75008 Paris, registered under number 844 443 390 RCS PARIS. The information does not presume the suitability of the UCI presented to the profile and experience of each individual investor. Rothschild & Co Asset Management Europe shall not be liable for any decision taken on the basis of or inspired by the information contained in this document. In case of doubt, and before making any investment decision, we recommend that you contact your financial or tax advisor. The Undertaking for Collective Investment (UCI) presented above is organised according to French law and regulated by the French financial markets authority (AMF). Any investment is always subject to risk. Before any investment, please imperatively read the key investor information document (KIID) and prospectus of the UCI carefully, especially its section relating to risks. Each investor must also 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: www.am.eu.rothschildandco.com. The information presented is not intended to be disseminated and does not constitute in any way an invitation for US nationals or their agents. The units or shares of the UCI presented in this document are not and will not be registered in the United States pursuant to the U.S. Securities Act of 1933 as amended ("Securities Act 1933") or admitted under any law of the United States. These units or shares may neither be offered, sold in or transferred to the United States (including in its territories and possessions), nor directly or indirectly benefit to a "US Person" (within the meaning of Regulation S of the Securities Act of 1933) and equivalent persons (as referred to in the US "HIRE" Act of 18 March 2010 and in the FATCA provisions).

Figures provided relate to previous years. Past performance is not a reliable indicator of future performance and is not constant over time. The value of investments and the income derived from them may vary both upwards and downwards, and is not guaranteed. The value of investments and the income derived from them may vary both upwards and downwards, and is not guaranteed. It is therefore possible that you may not recover the amount originally invested. Exchange rates variation may increase or decrease the value of the investments and the resulting income when the reference currency of the UCI is different from the currency of your country of residence. UCIs whose investment policy is aimed more specifically at specialised markets or sectors (such as emerging markets) are generally more volatile than common and diversified allocation funds. For a volatile mutual fund, the fluctuations may be particularly large, and the value of the investment may therefore fall sharply. The performances presented do not take into account any fees and commissions received on the subscription and redemption of units or shares of the UCI herein. The portfolios, products or securities presented are subject to market fluctuations and no guarantee can be given as to their future development. The tax treatment depends on the individual situation of each investor and may be subject to change.

Rothschild & Co Asset Management Europe, organized under the laws of France, registered with the Trade and Companies Register of Paris RCS Paris 824 540 173. A management company licensed by the Autorité des Marchés Financiers under N° GP 17000014, having its registered office 29, avenue de Messine, 75008 Paris, France.

About the Asset Management's division of Rothschild & Co

As the specialised asset management division of the Rothschild & Co group, we offer personalised asset management services to a broad client base of institutional investors, financial intermediaries and distributors. Our development is focused on a range of open-ended funds, marketed under four strong brands: Conviction, Valor, Thematic and 4Change, and leveraging our long-term expertise in active management with conviction as well as in delegated management. Based in Paris and established in 9 European countries, we manage more than 23 billion euros and employ nearly 160 people. More information at: www.am.eu.rothschildandco.com



Join us on **LinkedIn**

For further information
am.eu.rothschildandco.com

Rothschild & Co
Asset Management