

February 2023 | Rothschild & Co Asset Management Europe



Fund update

R-co Conviction Equity Value Euro



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Market trends on the month

After a challenging year for the financial markets in 2022, with its historic and global round of monetary tightening, 2023 began with a bang and the hope that tightening would be brought to an end. Driven by further declines in inflation, China's reopening, and the easing of the energy crisis in Europe, the markets began 2023 with unexpected headwinds (the MSCI World and S&P 500 rose, respectively, by +7.1% and 6.3%, with dividends reinvested, while the Eurozone outperformed by far, with the EuroStoxx gaining 9.3%)⁽¹⁾.

In the United States, while Q4 2022 growth was a positive surprise, with GDP up by 2.9% QoQ vs 2.6% forecast⁽²⁾ and the job market remained just as surprisingly resilient (with an unemployment rate stable at 3.5% and 223,000 job creations in December), several indicators are pointing to a slowdown in the US economy. The ISM manufacturing merely slipped from 49.0 to 48.4 on the month⁽³⁾, but the ISM services dropped hard (from 56.5 to 49.6 in January) and surprised on the downside (55.0 had been forecast). Meanwhile, the real-estate sector continued to be hit by rising interest rates, as seen in another decline in housing starts (-1.4% in January). Core inflation continued to recede, from 6.0 to 5.7%⁽⁴⁾, and – just as encouraging – the annualised pace of wages also declined, from 5.1% to 4.6%⁽⁵⁾. The *consensus* was almost unanimous on a coming 25 basis point (bps) hike in Fed rates, and that is indeed what happened at the 1 February meeting.

In the Eurozone, GDP growth figures may have been lower in the United States (Q4 2022 at +0.1%) but still held up well. Meanwhile, the further decline in natural gas prices, the reopening of China (to which the Eurozone is heavily exposed) and the improved *momentum* in leading indicators (with the PMI Composite at 50.3, its third consecutive month of increase and positive surprise⁽⁶⁾) raised investors' hopes for a soft landing of the economy, whereas recession had looked inevitable for several months prior. Although core inflation rose back to 5.2% (vs 5.0% the previous month)⁽⁵⁾, Eurozone consumer confidence improved from -22.2 to -20.9⁽⁷⁾. The ECB delivered a 50-bps rate hike at its 2 February meeting, as the market expected.

And, lastly, in China, macroeconomic figures showed some resilience in activity, while the effects of the reopening remain to be seen. Q4 GDP held steady, whereas a decline had been expected, and the decline in December sales was not as sharp as expected, at -1.8% YoY vs. -8.6% forecast⁽⁸⁾. On the supply side, manufacturing output rose by 1.3% (YoY), vs. 0.2% forecast⁽⁸⁾.

Bond yields priced in an easing in monetary policies, with the 10-year US yield pulling back by 37 bps (-31 bps for real rates), and the Bund by 28 bps (-19 bps for real rates)⁽¹⁾.



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(1) Source: Bloomberg, 31 January 2023.

(2) Source: Bloomberg, 26 January 2023.

(3) Source: Bloomberg, 4 January 2023.

(4) Source: Bloomberg, 12 January 2023.

(5) Source: Bloomberg, 06 January 2023.

(6) Source: Bloomberg, 2 March 2023.

(7) Source: Bloomberg, 23 January 2023.

(8) Source: Bloomberg, 17 January 2023.

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In the run-up to fourth-quarter 2022 reporting season, earnings per share (EPS) forecasts were revised downward rather sharply on the month (-2.4%)⁽⁹⁾, with EPS growth forecasts (ex commodities) now at +6.9%, vs. 10.2% in late September 2022. The European market posted gains *via* repricing, with the P/E of the EuroStoxx with dividends reinvested rising from 11.7x to 12.9x⁽¹⁰⁾. In terms of style, Growth's P/E rose from 19.2 to 21.0x, while Value's barely budged, from 8.6x to 9.1x. The valuation premium of Growth over Value thus rose from 123% to 130%, still close to its all-time highs. As a result, and despite Value's significant outperformance in 2022 (+11.8 points between EuroStoxx Value and EuroStoxx Growth) and despite the change in paradigm long discussed on interest rates, this premium leaves Value's rebound potential intact, just as hopes seem to be emerging for a cyclical recovery.

Fund performance & positioning

It is precisely the hope of a recovery in the European economy that drove this January 2023 rally on European markets *via* cyclical and financial sectors. Retailing (the third-worst sector in 2022 a -26%) gained 17.3%. Consumer goods (including luxury goods) and Technology were both up by 16.3%, and Banks by 15.9%. Underperformers were clearly more defensive (Food & Beverages +1.6% and Utilities +1.5%), although Energy ended the month as the worst-performing sector, at -0.2%. The pullback of sovereign yields favoured the Growth style (10.4% on the month), which outperformed Value by +1.9 points on the month (+8.5%)⁽¹⁰⁾.

R-co Conviction Equity Value Euro took full advantage of the market rally, gaining +11.2%, thus outperforming its benchmark index by +1.9% and the EuroStoxx Value by +2.6%⁽¹⁰⁾. The fund's outperformance was driven mostly by stock-picking and the outstanding showing by some of our convictions (UniCredit +34.7%, STMicroelectronics +30.6%, Faurecia +28.4%, Ryanair +21.7%, Alstom +19.2%, etc.)⁽¹¹⁾. All in all, 15 of the portfolio's 42 holdings gained more than +15% in January 2023⁽¹¹⁾. All 15 were cyclicals and financials.

This rally nonetheless only marginally reduced the discount of cyclical sectors to defensive sectors. In fact, the EPS revision that began a few months ago, as mentioned above, was mainly in those sectors that are most sensitive to the economy, which are most likely to suffer from pressure on margins and the consequences of inflation. This discount thus remained close to its all-time lows⁽¹²⁾ and highlights the importance of EPS trends and, hence, trends in the macroeconomic environment for the rest of the year.

2023 EPS growth is now forecast at 6.9% (ex commodities and energy), which still looks high to us and will require the confirmation of a true recovery in Europe. As usual, the markets have already partly priced this in. But we are confident that equity markets still offer some upside for 2023, particularly Europe, whose risk premium is more attractive than the US's (4.9% vs 4.1%)⁽¹³⁾, and which offers various potential catalysts (an acceleration of the Chinese economy in H2 2023, less pressure on natural gas with the reconstitution of inventories well underway, and a normalisation or even resolution of the geopolitical situation in Ukraine), and renewed investor confidence that has shown up so far this year in the net inflows into European equities (after more than 40 consecutive weeks of net outflows in 2022). We also continue to believe that this potential market upside will not follow a straight line. Central banks will have to continue their tightrope walk between inflation, which could see some bumps (see inflation in Spain in January, which rose from 5.5% to 5.8% vs. 4.8% forecast)⁽¹⁴⁾, the possible return of tensions in energy prices, the impact of the Chinese recovery, and a solid job market, which, boosts the economy but also feeds inflationary pressures. We therefore sought to contain portfolio cyclicality, rather than increasing it, which resulted in a decline in a defensive pillar by 1 percentage, from 24% to 23% on the month.

This calibration was done through some shuffling and position-taking. We have reduced our position in Arcelor Mital, whose appreciation since October (+45%)⁽¹⁰⁾ seemed to us to incorporate the Chinese reopening to a large extent. We also reduced our position in Airbus, which tapped into the pro-cyclical movement without truly suffering from its operating difficulties. This profit-taking allowed us to reinvest in cyclical stocks, which we felt offered greater upside, such as Deutsche Post and Ryanair. They also allowed us to open a position in Vonovia, a German property company that took a hit in 2022 (-55%)⁽¹¹⁾ from its heavy leverage and the rising-interest-rate environment. As it is riding a buoyant German residential market and trading at a -56%⁽¹⁵⁾ discount to its real assets, this investment looked timely for both fundamental reasons and to tap into a potential receding in sovereign bond yields. In order to limit the debt levels of our positions, we also financed this investment by selling off Atos, which had gained more than 45% in the first half of January on rumours that it would divest its cybersecurity division.

(9) Source: Europe Weekly Kickstart Goldman Sachs 03/02/2023.

(10) Source: Bloomberg, 31 January 2023.

(11) Source: Bloomberg, 31 December 2023.

(12) Source: Exane, 31 January 2023.

(13) Source: GS Global Weekly Kickstart 06/02/2023.

(14) Source: Bloomberg, 30 January 2023.

(15) Source: GS Global Weekly Kickstart.

(16) Source: GS Europe Weekly Kickstart 3 February 2023.

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All in all, market trends, earnings releases, and the macroeconomic environment reinforce our main conviction for 2023 – banking. The sector, whose earnings should continue to reflect the impact of higher interest rates, will, in our view, be the main beneficiary of the improvement of the macroeconomic environment. The sector could feature upward revisions in EPS forecasts, a return of cash to shareholders, and a steep rerating of its multiples within an economic cycle that would fall into the famous new interest-rate paradigm. This is also the sector whose EPS forecasts were revised the most on the month (+1.9%)⁽¹⁶⁾, helped along by a good start to reporting season (see UniCredit: +12% on the release of its figures).

Completed writing on 7 February 2023

Performances	2022	2021	2020	2019	2018	2017	Since inception ⁽¹⁾	1-year volatility
R-co Conviction Equity Value Euro C EUR	-9,63%	26,30%	-9,85%	17,64%	-18,01%	14,74%	93,27%	22,68%
R-co Conviction Equity Value Euro I EUR	11,23%	-9,05%	27,14%	-9,18%	18,53%	-17,42%	85,5%	23,13%
Euro Stoxx [®] NR ⁽²⁾	-12,31%	22,67%	0,25%	26,11%	-12,72%	12,55%	85,09%	19,69%

(1) Inception date: 20 May 2005.

(2) Benchmark.

Source: Rothschild & Co Asset Management Europe, 31/01/2023.



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(16) Source: GS Europe Weekly Kickstart 3 February 2023.

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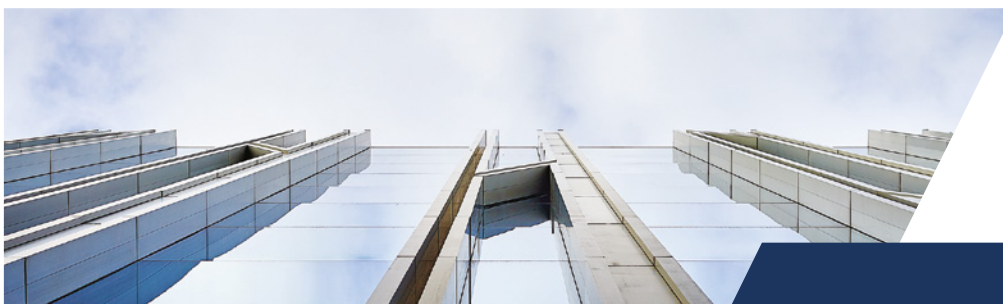
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