STONEHAGE FLEMING

6 April 2024

Dear Equity Client

GLOBAL BEST IDEAS EQUITIES – 1st Quarter 2024

Performance

World equity markets continued on their positive trajectory that started in October last year. The MSCI World Index (including Emerging Markets and dividends) grew by a further +8.1% (in US$ terms, +9.3% in UK£ terms). The Dollar strengthened by +3.1% over the quarter (against a basket of trading currencies), dampening Dollar returns.

Macro Backdrop

The continuing resilience of the US economy and its better than expected employment data are supporting investor confidence. The positive turn in the well-respected Conference Board US Leading Economic Index is a further welcome indication that a material US recession is not imminent, with perceptions rather growing for a soft economic landing. Whilst US headline inflation appears somewhat sticky at just over 3%, the cost of accommodation rent (the main inflation culprit) continues its downward trajectory (currently at 5.8%).

The combination of these economically fundamental issues clearly indicate that there is little reason for the Federal Reserve (Fed) to cut their target rate anytime soon. The ten-year Treasury yield has recently moved in sympathy, rising from 3.9% to 4.2% over the quarter. We believe this reflects a stronger-than-expected economy rather than a material change in risk appetite.

The US reporting season delivered a positive overall absolute result, well ahead of consensus expectations. Those companies' shares that disappointed on their outlook commentaries were marked down materially.

Portfolio Comments

Stock market performance continued to be driven largely by the Digital/AI industry theme. The three best contributors to our portfolio performance over the quarter were ASML, Microsoft and Edwards Lifesciences. Our additional investments in Amazon also performed very well over the quarter.

Whilst many Healthcare stocks suffered in the fourth quarter of last year from negative sentiment caused by the hype around the potential benefits of GLP-1 weight loss drugs, many of those share prices have since turned for the better. Along with Edwards Lifesciences, our Stryker and Thermo Fisher holdings also recovered.

The largest detractors from performance have been Zoetis, Nike and Adobe. Zoetis suffers from side effect uncertainties in a new drug, along with an EU antitrust probe. Nike disappointed with an unusual strategy of restricting the distribution of key products (Air Force 1 and Pegasus 40) ahead of new innovation launches. Adobe disappointed with soft short-term guidance, whilst maintaining their long-term targets. The share now suffers from high AI expectations not materialising in the immediate future.

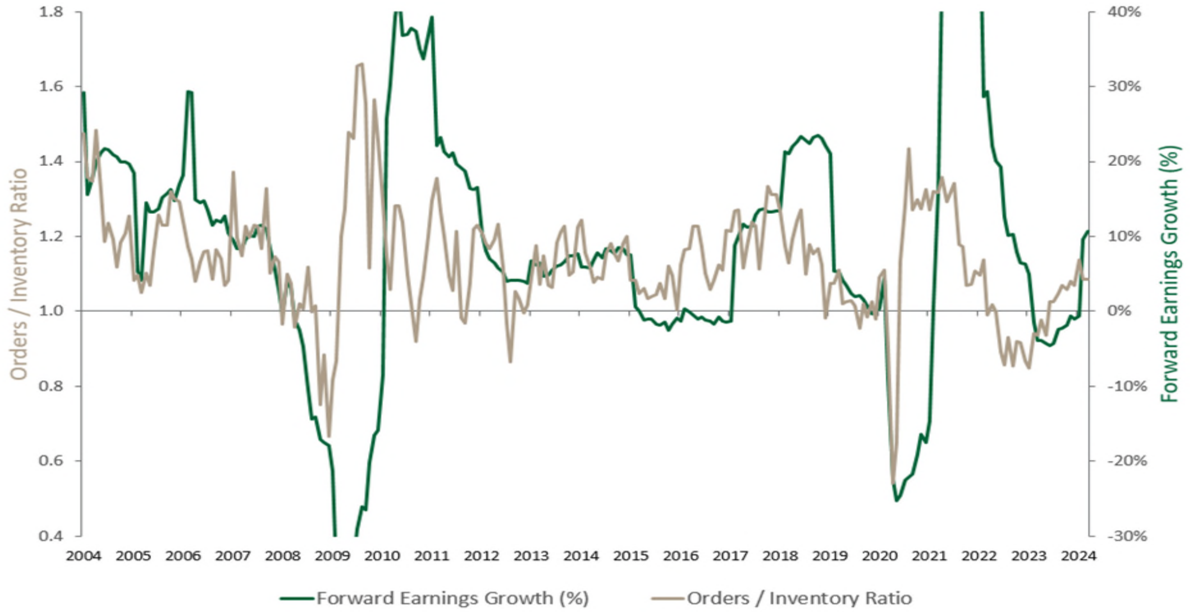
We continue to be pleased with the operational and share price performances of our two most recent introductions to the portfolio – namely Linde and AJ Gallagher. Linde's growing margin, its strong free cashflow and their well-subsidised investment programme in green hydrogen are the main attractions. Gallagher's simple business model and strong free cash flow ensure further good organic growth.

No new positions were introduced over the quarter, and no sales were initiated. We early in the year marginally increased our holding in UnitedHealth and repurchased a material portion of the LVMH that we sold last year. We also further added to Amazon, which, assisted by its strong performance, elevated it to a top-5 position. Lastly, we topped up our existing Estée Lauder and Adobe holdings.

Outlook

Whilst Manufacturing has been weak for several quarters in most major economies, there are strong indications that it is now turning for the better in both the US and China. The JP Morgan Global Manufacturing PMI index has recently moved into constructive territory. Many commodity prices have also enjoyed a strong quarter.

US – Orders/Inventory PMI Ratio vs Consensus S&P 500 12-month Forward Earnings Growth



US Consumer Confidence remains stable. As depicted in the above chart, US industry order numbers are increasing, whilst inventories are dropping – a sign that purchasing managers have been too conservative and their inventories have become depleted. This necessary restocking may in itself support company earnings. Consensus S&P 500 earnings growth expectations are increasing at an accelerating pace.

Summary

The global, and specifically the US economic backdrop, is in better shape than many had predicted. As the Fed is expected to bide their time before cutting the target rate, investors are looking to their businesses to continue to deliver operationally. The odds are improving for them to deliver, with Fed support becoming a feature in the second half of the year. We remain focussed on our best-in-class businesses that deliver consistent growth at attractive valuations, and will consider new opportunities that the market may offer.

We appreciate all your support.

With best wishes.

Gerrit Smit
Partner – Head of Global Equity Management

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