

Evenlode Global Equity Investment View

April 2024 – First quarter results 2024

All market data is from FactSet and FE Analytics unless otherwise stated. Past performance is not a guide to future returns.

Equity markets began 2024 with a continuation of the strong up-trend which kicked off in late October 2023 when US economic data and policymakers began signalling that US rates had probably plateaued, setting up a cutting cycle in 2024. As it happens, the US economy and inflation data have proved stubbornly strong in 2024 so far, and the narrative has switched to one of accelerating economic expansion and the potential for generative AI to open up further productivity gains. In the quarter, benchmark rates moved up across the curve, particularly in the US, but classic ‘animal spirits’ scrubbed off any tightening effect as credit spreads narrowed, leaving borrowing costs more or less unchanged. Combined with buoyant equity valuations, financial conditions are arguably more favourable than they have been since late 2021.

The Evenlode Global Equity portfolio rose in the first calendar quarter but lagged the broader MSCI World Index, which we use as our reference benchmark, by about 4.7%. This is by far the worst quarter we have had in the fifteen since we launched the strategy in July 2020. It was also an extraordinarily powerful quarter for the price momentum factor – in layman’s terms, stocks which had gone up a lot in the previous three to six months tended to keep going up. The MSCI World Momentum Index rose more than twice the broader MSCI World Index, increasing 21.2% vs. the index up 9.9% in GBP terms. This degree of outperformance was the third-largest since the Momentum Index’s inception in Q3 1973, surpassed only by Q4 1984 and Q4 1999, and was to the statistically minded a 2.8 standard deviation event.

Two points are relevant. Firstly, we would not make too much of the 1999 comparison, as we are very aware that equity markets are what those statisticians would call a ‘non-stationary’ time series, in which the past doesn’t have the same deterministic effect that it does in stationary series (think coin flips or sunspots). The intuition behind this is that markets remember in a way coins being tossed do not – the history of booms and busts has a ‘scarring’ effect on the collective minds of investors and means we cannot automatically extrapolate from what followed after Q4 1999 or, for that matter, Q4 1984.

Secondly, there is a logic behind the relative underperformance of Evenlode strategies in the first quarter, over and above the composition of the momentum bucket, which we discuss further below. Evenlode’s valuation discipline and process means that we rebalanced all our portfolios through the quarter into positions which were becoming better value as prices fell, in a market where this was an unusually punishing trade for relative returns. Our focus is on a company’s cash earnings potential, adjusted for risk and capital intensity, over a horizon of five years and beyond, so there will be times when price momentum and long-term earnings potential diverge. When this happens, we will always follow long-term earnings potential.

There will also of course be times when price momentum and long-term earnings align. In other words, our strategies are not *necessarily* negatively correlated with momentum, particularly when it is more normally related to the wider index. However, history suggests that when momentum is unusually strong, our style is likely to suffer in relative terms. We think this is particularly the case



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right now when momentum, to our eyes, is being fed by two separate waves, both of which tend to exclude our portfolio.

In the first group, as was the case in 1999 with the TMT bull market, powerful thematic trends around generative AI and drug innovation in GLP-1s for diabetes and obesity are driving some mega caps to extraordinary new highs. While we have some exposure to the generative AI trend through Alphabet, Amazon, and Microsoft, we have tended to avoid pure plays on these trends as we are cautious around cyclical and high thematic concentration.

Secondly, more like the Volcker boom of the 1980s, securities prices are being adjusted upwards after a period of inflation and a widely feared recession, in expectation of continued declines in borrowing costs and a resurgent global economy driven by the US. This has restrained the relative performance of companies which are less sensitive to changes in rates and economic growth. With that being said, work we have done on fundamental earnings revisions suggests that our portfolio companies' earnings expectations were little different to those of the index during the quarter.

We prefer not to spend too much time worrying about factors and the macro context. The analysis above is relatively rare and we think is what we owe to our investors in a period of underperformance. While there have also been stock specific issues which we are learning from, even with those pulled out we would still have lagged the index materially. The resilience of our portfolio companies' earnings, both in the Q4 2023 reporting season and in the incremental revisions to consensus, makes us additionally confident that we have not strayed in our pursuit of compounding ability.

There are many things our companies are up to which excite us and which, over time, we expect will be more ingots of treasure to heap onto the 'weighing machine' of cumulative shareholder earnings described by Benjamin Graham. We plan to write more in future on some of these initiatives, including but not limited to the opportunity for the card networks Mastercard and Visa to expand their sales of value-added services to issuers, acquirers, and merchants, the opportunity for traditional data firms like Verisk, Experian, and RELX to improve the productivity of clients by offering more sophisticated analytics packages, and the opportunity for beauty and spirits companies like L'Oréal and Diageo to expand their footprint in emerging markets while further extending their innovation-based pricing pyramids in developed markets.

We look forward to being in touch again soon,

Chris (E), James, Cristina, Gurinder, and the Evenlode Team

22 April 2024

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