

Evenlode Global Equity Investment View

June 2024 – Q2 2024 update

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

The equity markets continued to post positive returns over the past three months, but the rate of growth decelerated substantially from the first quarter. Sector specific optimism plus mixed macro messages has yielded an almost unprecedentedly narrow market. For both us and the wider active fund management market, this has created an unusual environment where relative performance against the index is increasingly dictated by whether you are over- or underweight a few of these key names.

The signalling on interest rate cuts remained unchanged in both the US and UK during the period, with central bankers pointing to continued strength in economic data and delaying action. This contrasts with the European Central Bank (ECB), which reduced its main interest rate from 4% to 3.75%. This represents the first reduction of rates from a twenty-year high for the Eurozone. The decision was made despite Christine Lagarde, president of the ECB, acknowledging that inflation is likely to be above the target rate of 2% for both 2024 and 2025. Predictions over rate cuts are made all the muddier by recent and ongoing elections in the UK, France and the US, and while central banks are expected to act independently, the threat of looser fiscal policy will clearly affect decision making. As much of the wider equity performance has been tied to these rate expectations in recent years, it is perhaps unsurprising that the market performance is largely muted at present.

Startlingly, just seven companies accounted for 130% of the MSCI World Index's total return in the quarter, according to FactSet: Alphabet, Amazon, Apple, Broadcom, Eli Lilly, Microsoft, and Nvidia, which on its own was 47% of the total MSCI World Index return. The fund held three out of this "Alternative Seven", but their benefits were fully offset by other parts of the portfolio, where weakness was broadly spread across sectors and indifferent to operational momentum.

Nvidia have built an impressive server system, seeking to optimise at every part of hardware and software. This has created a technology lead that has allowed the company to dominate IT capital expense budgets in anticipation of increased use of Artificial Intelligence (AI). Two questions are looming with increasing importance; firstly how long it will take for generative AI to become financially productive for these buyers of Nvidia tools, and secondly how resilient Nvidia's competitive position is against its customers, given it increasingly competes with the most important ones directly. Given our focus on predictable and durable earnings power, it is a challenging fit for our process, particularly at these valuations, but we believe that companies with more Evenlode-congruent business models like Alphabet, Amazon, and Microsoft are all likely to benefit from generative AI as and when it scales to ubiquity.

Additionally, many data businesses within the Evenlode Global Equity portfolio have potential applications and we are seeing the occasional use – for instance, RELX has a new search feature within the Lexis Nexus legal tools. Attractively, their access to proprietary data appears to give them a growing structural advantage as the cost per unit of compute collapses. Generative AI like any other innovation is taking time to scale, and we are happy to be invested in companies whose earnings are not contingent on rapid scaling; Amazon and RELX earnings forecasts at this time are not discounting



Evenlode Global Equity Investment View

June 2024 – Q2 2024 update

meaningful acceleration from generative AI. It seems unlikely that the narrowness of index performance can continue. The earnings picture has been far more balanced than the price chart picture, with many more companies posting solid earnings growth outside of the technology titans, so it seems these unusual market conditions are unlikely to repeat.

Looking ahead

For the portfolio, the fundamental results remain encouraging. In the first calendar quarter (Q1 2024), the portfolio grew organic sales between 7 to 8% and continued to expand operating margins (by approximately 140bps on average). Encouragingly, the portfolio companies' performance was far less skewed than the wider benchmark, with only five companies failing to grow organic revenues by mid-single digits or higher. As importantly, these businesses continue to make intelligent and pro-active investments in their core competitive assets, often when less adequately resourced peers are unable to do so. Our experience, both as a team and firm, suggests that this difference in investment is the best predictor of future market share gains and long-term cash flow compounding. As such, we remain confident and happy owners of them.

Eventually company fundamentals determine returns to shareholders, not the other way around. We do not know when the gravity of superior cash earnings compounding and sustainability will make its force tell, but history suggests that it cannot be deferred indefinitely. The macro-economic and political uncertainty of the second half will resolve. Rate cuts will come eventually, though with uncertain pace and timing, and it is highly unlikely that the narrowness of the market continues. In the meantime, businesses that properly invest and do not take excessive risks will continue to generate good fundamental results for their investors.

Portfolio update

In the second quarter, we initiated a position in the Swiss premium chocolate maker, Lindt & Spruengli, in early April. Lindt has a 5% share of the global chocolate market, though it operates exclusively in the premium segment, which accounts for 20% of global chocolate sales. As the premium segment expands its share of the overall market, Lindt has also been increasing its own share, by investing in more production and its own retail outlets. This expansion has been most notable in the US, as consumers shift to premium chocolates and chocolate gifting has increased.

Our top contributors for the quarter (Alphabet, Verisk Analytics, RELX, Experian and Microsoft) are all businesses that provide software, data, and services to their clients. These companies may appear natural beneficiaries of the rise of AI as they can integrate the new technology into their products. However, their ability to add value to clients is primarily dependent on a deep understanding of client workflows and needs.

Our largest detractors were Mastercard, Diageo, Accenture, Medtronic and Pernod Ricard. Regarding Diageo and Pernod Ricard, while we believe from conversations with the channel and manufacturers that unusually high post-Covid inventories have normalised, consumer purchases are still suppressed which is likely to be a mixture of consumers working down home stocks on spirits, and belt tightening after the powerful inflation of 2022-2023. It is worth noting that although Mastercard was the largest



Evenlode Global Equity Investment View

June 2024 – Q2 2024 update

negative contributor, it had been one of the strongest over both the prior quarter and year. We remain confident that all these companies have good long-term growth prospects.

Industrials remains our greatest contributor by sector. Our exposure is primarily to the Commercial & Professional Services sub-sector, with companies that provide data or software to their clients. These businesses have highly recurring revenues and renewal rates, as their services are deeply integrated into their client operations. Communication Services is primarily our exposure to Alphabet which performed well.

Information Technology was our largest negative relative contributor. We remain underweight the sector. This is driven in part by valuation, and in part by MSCI's decision to reallocate technology businesses with high vertical integration to their 'home' GICS vertical, e.g. Jack Henry, Mastercard, and Visa to Financials, Amadeus to Consumer Discretionary, Broadridge to Industrials. The weak performance in Consumer Staples was primarily driven by the spirits companies, though wider consumer sentiment seems depressed with heightened economic and political concerns. Our expectation is that those businesses that can continue to invest through times of weaker consumer sentiment will emerge stronger and capture increased market share. Our relative underperformance in financials was primarily due to our lack of exposure to banks, which performed strongly in the quarter due to expectations of rates being held higher for longer.

We look forward to being in touch again soon,

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

8 July 2024

Please note, these views represent the opinions of the Evenlode Team as of 8 July 2024 and do not constitute investment advice. Where opinions are expressed, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice. This document is not intended as a recommendation to invest in any particular asset class, security, or strategy. The information provided is for illustrative purposes only and should not be relied upon as a recommendation to buy or sell securities. For full information on fund risks and costs and charges, please refer to the Key Investor Information Documents, Annual & Interim Reports and the Prospectus, which are available on the Evenlode Investment Management website (<https://evenlodeinvestment.com>). Recent performance information is also shown on factsheets, also available on the website. Past performance is not a guide to future returns. The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Fund performance figures are shown inclusive of reinvested income and net of the ongoing charges and portfolio transaction costs unless otherwise stated. The figures do not reflect any entry charge paid by individual investors. Current forecasts provided for transparency purposes, are subject to change and are not guaranteed. Source: Evenlode Investment Management Limited, authorised and regulated by the Financial Conduct Authority, No. 767844.

