

After a downbeat October, Mr Market's mood recovered in November and global stock markets posted strong gains. In both Europe and the US, a continuing decline in the inflation rate suggested interest rate reductions may begin earlier in 2024 than previously expected. And though the global economy continues to slow, it has done so at a measured pace thus far. A falling oil price was also helpful for sentiment. In short, though economic uncertainty and geopolitical unrest by no means disappeared in November, the backdrop became incrementally calmer. Since the start of the year, Evenlode Income has risen +4.4% compared to a rise of +3.3% for the FTSE All-Share and +1.8% for the IA UK All Companies sector<sup>i</sup>.

### Field notes

At the company level, third quarter results season has come and gone, and stock markets are now heading into the quiet holiday season. In the face of a variety of challenges, results from fund holdings have remained reassuring in aggregate, with organic revenue growth averaging +6% year-on-year during the third quarter, free cash flow generation healthy, and the outlook for profitability improving as Covid-related supply chain issues continue to normalise and input cost inflation slows. Below is a little colour on several themes and businesses from across the portfolio.

### Digitalisation

Data analytics holdings continue to see strong demand as software 'eats the world', with companies across the global economy investing in digital tools to help improve their offerings and enhance efficiency and adaptability. Organic revenue over the latest reporting period grew +8% for RELX, +9% for Sage, +5% for Experian, +7% for LSE, +5% for Wolters Kluwer, and +12% for Microsoft.

Over recent years the growing sophistication in the analytical tools and services offered has led to a steadily deepening, highly embedded relationship with customers. As RELX put it, *the improving long-term growth trajectory continues to be driven by the ongoing shift in business mix towards higher growth analytics and decision tools that deliver enhanced value to our customers across market segments*. Our recent conversation with Experian's management team highlighted the same point. Experian's credit analytics software platform Ascend is used by more than 90% of the largest banks in the US, with a retention rate on subscriptions of 100%. More broadly, Experian's value-added services and recurring revenue helped the company grow by +5% over the last six months, despite the difficult industry backdrop within credit markets.

We've also discussed the potential impact of generative AI technology with a broad range of companies. Across all sectors, companies are experimenting with these models, and beginning to find ways to drive more efficiency into front and back-office processes - from drafting job specifications for recruitment consultants, to chasing aged debtors and adding more automation to customer support functions. This may lead to interesting long-term benefits for many businesses. In the shorter term, we expect the most visible impact to be for the software and analytics holdings, where generative AI is leading to new services that will help drive growth. RELX, for instance, is now piloting Lexis+ AI with its clients, which automates a range of activities for lawyers including letter and email drafting. Sage will be launching its 'Copilot' assistant next year, to help small companies automate a range of back-office processes.



### Nudging the portfolio

Though these digitalisation trends are healthy, we have trimmed back holdings such as RELX, Sage, Wolters Kluwer and Microsoft over recent weeks, following very strong share price performance, and recycled the capital into a wide range of other portfolio holdings where less positive share price performance leaves our estimates of forward return looking more attractive (Diageo, Burberry, Reckitt, Roche, Halma, Smith & Nephew, Hays, Spirax-Sarco etc.).

### Consumer branded goods

Two of the names on the above list – Diageo and Burberry – were the most significant negative contributors to return in November. Their share prices fell by approximately -11% and -13% respectively. Diageo downgraded sales growth expectations for its current financial year due to destocking trends in its Latin America division. Though we acknowledge these challenges, we do also remain attracted to the company's market leading global brands, pricing power, and growth potential from both premiumisation trends and its strong emerging market footprint. Burberry reported solid revenue growth of +7% at its interim results, but management noted a demand slowdown over recent months, and now expect full year results to be at the lower end of the forecast range. After this year's share price underperformance, both Diageo and Burberry's valuations are at multi-year lows.

Elsewhere within the consumer branded goods sector steady performance was reported, with organic revenue growth +5% for Unilever, +3% for Reckitt, +7% for P&G, and +9% for PepsiCo. Profitability trends are also improving as input cost inflation slows significantly. As with Diageo and Burberry, the valuations of both Reckitt (as discussed in last month's investment view) and Unilever stand at multi-year lows.

### Speciality engineers

The portfolio's engineering holdings are now seeing supply chains return to a more normal situation after the Covid-related distortions of the last three years. They will also benefit from the huge investments that will be made to upgrade and decarbonise the global industrial economy over the next decade. Halma, Spirax-Sarco, Rotork, Smiths Group and Spectris all look well placed in this regard – across a variety of different end markets. Smiths Group mentioned this week that its John Crane division, which provides high-performance seals in a wide range of industrial applications, has seen its pipeline of green energy projects (green hydrogen, carbon capture, methane emission reduction etc.) double over the last year. For Spirax-Sarco, its steam division has historically tended to grow at approximately twice the rate of global industrial production growth. Over coming years, management now expect growth to be above this level, thanks to demand for the company's unique set of products that enable customers to remove carbon emissions from the steam generation process.

### Strong grow stronger

The strong grow stronger theme is visible in many areas of the portfolio. Sensibly run, well capitalised companies with market leading positions are well placed to strengthen their competitive position when times are tough and interest rates are high. We suspect that this theme has further to run. In many sectors, new entrants or small competitors are often unprofitable or highly indebted and funded by venture capital or private equity owners. In some sectors, we are hearing the odd anecdote of small



competitors (after offering heavily discounted prices, often for years) putting through significant price hikes as their owners are no longer able or willing to subsidise losses. Such erratic behaviour doesn't tend to redound well on a company's long-term reputation. Another trend is that acquisition valuations are beginning to trend lower, as financing costs have jumped in the last two years. This is positive for businesses such as Bunzl, Diploma and Halma, all of whom make regular bolt-on acquisitions as part of their business-as-usual strategy – which they finance with internally generated free cash flow.

The strong grow stronger theme is particularly prevalent in more economically sensitive sectors where the end market backdrop is difficult. At present this applies to holdings such as Savills, Page, Hays and Howden Joinery. All these companies are well run, enjoy strong net cash balance sheets, and are quietly strengthening their position in the current downturn – even though you can't see it in their current financial results. When conditions start to improve, they will be well placed to benefit.

For a sense of this process, recent trading at Compass and Informa is worth highlighting. These holdings are global market leaders in the food catering and trade exhibitions respectively. Though their industries were significantly impacted by Covid lockdown restrictions, they were able to quietly strengthen their positions during this period and are now benefiting as their end markets recover. Sales growth for Compass and Informa was +19% and +32% respectively for their most recent trading periods, with revenues now comfortably above pre-Covid levels for both companies.

### **Broad opportunity set**

As discussed in recent investment views, the rapid rise in interest rates over the last two years has, as well as raising the cost of borrowing, led to a valuation de-rating for many companies within the UK stock market – even for those that continue to make steady fundamental progress. This has tested the patience of equity investors, but it has also 'squashed' the valuations of most companies down to attractive levels. The opportunity set hasn't looked this broad to us since the early days of the fund in the 2009-2013 period, which we believe bodes well for the patient investor.

### **Getting rich slowly**

To mark the passing of Charlie Munger this week, at the age of 99, it feels appropriate to finish this view with a hat-tip to one of the great advocates of the steady cash compounding, 'get rich slowly' investment approach that we pursue at Evenlode. Munger understood that time is the friend of a good business – *the big money is not in the buying and the selling, but in the waiting* – and applied a high dose of discernment and patience to investment. He also pointed out that long-term investing might be simple, but it rarely feels easy and there is no room for complacency. Reading, hard work and continuous learning were key elements of Munger's advice for success in investment and life. We should all aim to go to bed each night a little wiser than we were when we woke up.



On the theme of reading, the Evenlode team will release our winter book list later this month. Then, in January, we will be back again to give a full review of 2023 and to discuss the outlook for 2024.

In the meantime, we wish you all a peaceful and enjoyable holiday season.

**Hugh, Chris M., Ben P. and the Evenlode team**

**8 December 2023**

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<sup>i</sup> Source: Evenlode, Financial Express. Evenlode Income B Acc (GBP), 31 December 2022 to 30 November 2023, total return, bid-to-bid, GBP terms.

