

Evenlode Global Dividend Investment View

November 2023 – The economic cycle vs the next big thing

Market data is from FactSet and FE Analytics.

Last month we started to draw out some of the themes emerging from companies as they reported their third quarter resultsⁱ, dwelling on inflation, revenues, and demand. As more information has come through from a broader range of businesses, we see that those early signs have been confirmed. In summary, disinflationary trends in corporate input costs are continuing, and we have seen this feed through to consumer price inflation slowing in the US and Europe over the last month. The oil price has moved downward again, having been edging up in response to Middle Eastern tensions, as the implications of slowing demand and the lack of disruptions to supply are reflected in a softening price.

Evenlode Global Dividend portfolio companies were pretty resilient on the whole, but the variation in market price reaction has been surprisingly high. We can think about this in the context of what has happened to companies in the most recent quarter, what's going on right now and in the near future, and what people are guessing at for the longer term for these businesses.

The past

For the portfolio there have been few surprises in terms of the reported results for the third quarter. The median organic revenue growth for the portfolio was +5%ⁱⁱ, and the general message of margin and cash flow improvement that we heard earlier in the year remained intact.

There were some stronger performances in revenue terms. Microsoft's momentum continued, increasing revenues by +12% with little sign of the previous cautious tone around enterprise spending coming to bear. Cosmetics juggernaut L'Oréal's top line increased by +11%, and the streamlined pharmaceutical and vaccines company GSK, shorn of its consumer goods unit Haleon that was spun off earlier in the year, saw +10% growth.

With the economic mood music generally slowing down there were of course some weaker performers, which had been flagged in advance. Japanese bicycle parts manufacturer Shimano saw revenues dive by -32% compared to the same quarter last year. We wrote about the near-term trends for the company shortly after initiating a position earlier this yearⁱⁱⁱ, but in short, a large inventory build-up of bike parts is working its way through the system whilst demand weakens. Transportation brokerage C H Robinson's revenue declined -28% as transportation rates normalised from an extreme cyclical high after the pandemic.

Both Shimano and C H Robinson are smaller positions in the fund, reflecting their cyclicity. Interestingly, despite such negative headline numbers and the slower economic situation Shimano's stock is up by +8% in yen terms over the month to the time of writing. Partly that reflects a weakening Japanese yen – Shimano sells to a largely international audience – but the stock is up in other currencies too. C H Robinson's stock price has declined but only slightly. Both come on the back of market weakness, and whilst too early to definitively call an end to that trend (the market will do what it will do) it is notable that something of a near term floor has been found. It is often said that Mr Market dislikes uncertainty, and perhaps the posting of some results, almost any results, is helpful when valuations and expectations are depressed. The other company to post declining revenue was



US medical testing laboratory outsourcer Quest Diagnostics as it processed fewer covid tests; its stock is up by around +10% over a month and has made back its declines of the last half year.

The present

Some companies are going along very nicely and have solid momentum for their sales growth and profitability. Global eyewear firm EssilorLuxottica increased revenue in the mid-single digits, despite sunglasses sales in the US being softer. The company's new lens offerings Varilux XR and Stellest, which deals with childhood myopia, have been particularly strong. Live event ticketing market leader CTS Eventim confounded fears that a post-covid boost from people desperate to get out of the house after the lockdown years would slow. The pandemic reminded us all that we are social creatures at heart, and it seems that many continue to be willing to spend on the little luxury of seeing their favourite artists and teams play. Data, software and analytics companies Wolters Kluwer and RELX continued their reliably steady growth, driven by a digitising world and a desire to manage risk and increase productivity in the professions that they service. These steady performers were looked upon favourably by the market and saw their share prices rise.

The most negative stock market reactions were reserved for companies that flagged a change in the picture, despite posting positive results for the quarter. French healthcare firm Sanofi surprised the market by announcing that it would be investing more behind its late-stage pipeline of products, including therapies for multiple sclerosis, dermatitis and in its vaccines portfolio. More detail is to come at an investor day focused on research and development in December, but we are supportive of companies investing behind growth opportunities. Sanofi also announced the planned disposal of its consumer healthcare business, an action which had been ruled out by the previous management team. This mirrors a similar strategy as that executed successfully by GSK.

Relatively new holding Diageo, the global market leader in spirits, reported a slowdown in its Latin American business, a market that represents 11% of group sales. Distributors in the market had been buying up additional inventory ahead of Diageo's signalled price increases, which were themselves in response to increased inflation. This was followed by a combination of an economic slow-down, limited ability to see what retailers are selling in some markets ('sell-out' in the jargon), and a reversion from peak post-covid sales. The result led to an inventory build-up at distributors, which will take a while to unwind. All this means that operating profit is expected to decline in this half year compared to 2023, and marks quite a change from the picture painted recently by the new management team. On the more positive side its large North American business is performing a little better than expected. The long-term picture for Diageo remains intact, with ongoing premiumisation trends and increased appetite for spirits in high growth markets such as India.

Network equipment giant Cisco said that positive sales over the last three quarters would lead to a slowdown in the next as customers installed the switches, routers and other gear that has been procured. Management said that their analysis shows this to be a digestion of inventory rather than to do with a broader macroeconomic slowdown, but nonetheless its stock was down by -10% on the day of the announcement.



Whether a company's results have been viewed favourably or not by the market is of interest, but more important to our investment process is asking the question 'has anything fundamentally changed for the long term?'. Things happen to companies all the time, some positive and some negative, but what we want to see is a commitment to invest behind a business's attractive franchise through thick and thin. If we are satisfied that this is the case, we can respond to a changed market valuation accordingly. We have added to the fund's holding in Diageo for example and will continue to build if the relative valuation continues to look attractive.

The future

Microsoft has been the greatest positive contributor to the fund's performance year to date. We will not rehash the discussion of generative artificial intelligence here, but it appears that the market's enthusiasm for Microsoft's launch of Copilot-AI contributed to the recent performance. We do not base our valuation on nascent products or unproven revenue streams. However, the ongoing demand for cloud computing and reacceleration of Azure sales demonstrates the value that Microsoft can provide for clients as they experiment and develop using new technologies. Our cash flow modelling indicates that the company is still trading at a fair value, although it is not looking as cheap as it was, and we have been managing the position size to prevent it becoming too large. Very recently the media has been gripped by the board room soap opera at OpenAI, the developer of the ChatGPT large-language model. OpenAI has been publicly and financially supported by Microsoft, who are integrating the generative AI service into their office 365 products through the Co-pilot toolset. Whilst the drama at OpenAI is intriguing, we don't think it changes the core value proposition of Microsoft's enterprise and development of productivity tools and services.

Other technology companies also performed well. IT consultants and outsourcers, Accenture and Capgemini, have both recovered as their clients have signalled increased commitment to technology spend in the coming years after fears of budget cuts earlier in 2023. Both businesses are adept at pivoting to new technologies and will be valued partners in developing new products and services for clients.

In a different area of the economy, global demand for cosmetics has a clear runway ahead and L'Oréal has performed accordingly in the market. The company has invested significantly in dermatology, increasing the scientific clout behind its market leading beauty brands. This has enabled the company to take market share in the US, but also further built customer loyalty – the long-term driver of growth in consumer goods.

The portfolio

As noted above we have made some changes to the portfolio in recent months as the market valuations of some businesses have diverged. Overall though the shape has changed relatively little – just over 30% of the portfolio is in consumer goods, around a fifth each is in information technology and health care firms, and another fifth in professional services companies. We continue to hold an outsized weight in UK listed businesses, where there is particular value at the moment. That comment can be broadened to this side of the Atlantic more generally, bringing in businesses listed on continental Europe as well – European listed businesses including the UK make up around 60% of the



portfolio, and 33% are listed in the US. Despite this, North American sales make up 45% of the underlying revenue stream of the portfolio, a figure that has been static over the lifetime of the fund despite the listing countries having moved around through time.

To summarize on corporate performance, whilst there have been a small number of weak results and some who are highlighting a slowdown to come in the near term, the performance has been solid. None of the negative headlines present a threat to the long-term health of the portfolio's franchises, but they have left valuations at undemanding levels. Some companies are in more of a sweet spot, and most are just doing what they usually do, churning out growth and reinvesting their cash flows for the future. We hope for benign economic conditions, but there are signs from some quarters that a slowdown is in progress. If things do get choppy this collection of businesses will tough it out, improve their market position, and ultimately drive growth in value for shareholders.

Ben, Bethan, Chris, Rob and the Evenlode team

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ⁱ<https://evenlodeinvestment.com/news/the-big-picture>

ⁱⁱAll financial figures are reported as organic growth figures unless otherwise stated. 69% of the portfolio by name and 67% by weight had reported a figure for the quarter at the time of writing.

ⁱⁱⁱ<https://evenlodeinvestment.com/news/business-development>

