Evenlode Global Dividend Investment View

October 2023 – The big picture

EVENLODE
GLOBAL DIVIDEND FUND

The commentary below applies to the Evenlode Global Dividend portfolio which follows the Evenlode Global Income strategy. Market data is from FactSet and FE Analytics.

As results updates from companies continue to trickle in, we are building an updated view of the global economic situation. It's early days yet, with about a quarter of the Evenlode Global Dividend portfolio having given an update, and next month we'll discuss some of the detail by sector and by company when the majority will have reported. We are nonetheless able to discern some themes emerging on the big picture from the story from business so far. At the nine month point most companies just report revenue figures rather than the full roster of profit & loss and cash flow, but the commentary can be illuminating as well.

Inflation

One of the bigger economic stories of recent years, in 2022 inflation made a sudden return and with it marked a shift away from the longstanding era of ultra-low interest rates. To recap, supply chains were out of kilter thanks to the coronavirus pandemic, and energy and agricultural commodities affected by the war in Ukraine. Companies suddenly struggled to secure the supply of inputs to production processes and their price was bid up accordingly, while the cost of energy soared. This impacted the input costs of companies, who responded by increasing prices to customers in order to make up for the impact on profitability, feeding through to a rapid increase in retail prices. This process was also fuelled in part by global demand being supported by massive government stimulus programmes coupled with the switch in spending to goods during the lockdowns of the pandemic.

Bringing the story up to date, the clear message from companies is that supply challenges are in large part easing and inflation is slowing. Indices of metals and agricultural products have come down, in some cases to pre-pandemic levels, and transportation rates have collapsed from very elevated levels. Procter & Gamble (P&G) reported a commodities price 'tailwind', and Nestlé said that dairy prices have fallen by a quarter this year. Economists are indicating that excess savings built up after the onset of the pandemic have now been largely depleted.

To date price rises have continued, demonstrated by price-driven revenue increases in the third quarter of the year by the consumer goods companies that have reported so far. With the supply picture ameliorating, the message from businesses is that these increases will slow. P&G reported a 520 basis point increase in its gross margin in the most recent quarter, a big swing back from last year helped by the commodities tailwind but mainly driven by price increases. With profitability levels recovering, there is less need for compensatory price increases, something that will be welcomed by shoppers around the world.

As with all narratives, there are nuances, exceptions, and caveats. One is the cost of energy, which has been creeping up in recent months. With tensions in the Middle East rising once again, the oil price has edged up once more. Given the unpredictability of the situation it is likely that it will be volatile for some time. A long-term factor affecting agricultural commodities in particular is the effects of climate change. The price of cocoa is at an all-time high because of concerns over the impact on production centred in a narrow belt of West Africa. We'll return to this theme below. Economically the inflationary effects of large governmental budget deficits and stimulatory policies such as the CHIPS Act and Inflation Reduction Act in the US remain in place, acting in opposition to monetary policy action by central banks and the disinflationary effects of supply chain easing.

Revenues and demand

The revenue figures so far reported in the portfolio are positive, in the high single digits on average. Again, we'll see how that looks in full over the course of the next few weeks and report back, but despite the positive figures the mood music suggests that the demand picture will moderate. In some cases, this is due to continued return to normal after the pandemic and can be quite product specific. Luxury goods giant LVMH reported falling cognac sales in North America after a covid-related boom in luxuriating at home. Demand from Chinese consumers has been a theme, with purchases moving from being made in the country to around the world as travel has re-opened. LVMH reported slowing sales growth in the country, although it remained in the double-digits in percentage terms. P&G's beauty division slowed due to its SK-II brand's performance in China. Many analysts are trying to read the tea leaves about what this means for the near-term economic picture, but companies are less worried about that than the long-term opportunity that the country still presents.

Elsewhere in the world European demand is moderating but seems to be holding up reasonably well. Eyewear market leader EssilorLuxottica, seller of Varilux lenses and Ray Ban frames amongst many other brands, said that the region was 'strong' for them. The North American weather held back sales of sunglasses though. Cosmetics were also strong in Europe – L'Oréal's revenues grew by 16% in the most recent quarter, representing a slight slowdown from the first half of the year, but still a high rate.

Glancing elsewhere in the macro picture we discussed the effects of higher interest rates in an investment view recently[i], the conclusion being that highly speculative assets and highly leveraged business structures are likely to be the most negatively affected. The companies in the Evenlode portfolios, including those discussed above, certainly do not fit that description. Their performance gives us an interesting view on the performance of the global economy, but whether they grow a bit faster or a bit slower, they have the financial strength and value proposition in their products and services to absorb volatility and churn out cash flow year after year. Over time that is valuable to investors through sustainable growth and managing the risk of large losses.

Sustainability

With a lot of macroeconomic and geopolitical news around, matters of sustainability have been a little less discussed in the media. The example of the cocoa price noted above shows that we should not forget about these. To take another example, the International Energy Agency (IEA) now forecasts that fossil fuel usage will peak before 2030[ii], which will likely have an impact on energy costs and capital expenditure plans in the medium term.

To their credit, companies certainly have their eyes focused on the long term whilst navigating the world day to day, with work continuing on net zero transitions and increasing transparency on matters of sustainability. We have continued to engage with portfolio companies on these, most recently to discuss their reporting plans under the EU's Corporate Sustainability Reporting Directive. We think that reporting and transparency, done well, are important in helping investors, governments, regulators and ultimately the public at large to understand opportunities and risks faced by companies and society. The IEA's forecast is encouraging; it shows that as an economic system we are starting to grapple with these challenges. We need to keep an eye on how these things continue to evolve as we assess the opportunities and risks on our clients' behalf, as part of and alongside the macroeconomic picture.

Ben, Bethan, Chris, Rob and the Evenlode team

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[i] *https://evenlodeinvestment.com/news/old-normal-vibes*

[ii] *https://edition.cnn.com/2023/09/26/energy/fossil-fuels-demand-peak-climate-action-iea/index.html*