Evenlode Global Investment View

November 2021 – Key Sectors

EVENLODE
GLOBAL INCOME FUND

The commentary below applies to both the Evenlode Global Dividend and Evenlode Global Income portfolios. Market data is from Factset and FE Analytics.

As the nights are drawing in and a turbulent 2021 approaches a close, we naturally consider what has come to pass, and what the future might hold. The latter is difficult at the best of times, but we at least can reflect on recent history. Socially-speaking us office-dwellers have at last been able to step out from behind our screens and interact with people in person, and it has been very nice to see some of you face-to-face. We think a mixture of in-person and on-line is here to stay, and we're happy to communicate with you in whichever forum you prefer.

Economically-speaking a gradual return to cafés, restaurants, pubs, theatres, festivals and holiday destinations has created spikes in demand, which have collided with supply chains that are still disrupted by the pandemic. Transportation costs have soared, and labour is hard to come by in some sectors. Following large sections of the global economy being shut down almost overnight, it is perhaps unsurprising that there are a few sputters in the re-firing of a globalised economy.

From an equity market perspective performance has proven to be anything but sputtering. Fired on by US-listed companies, the MSCI World index is up by 23.1% in sterling terms this year[i], and 38.3% since the end of 2019. The S&P 500 is up 26.7% and 42.8% over the same periods (sterling terms). The Evenlode Global Income fund is up 19.4% this year, and 23.6% since the end of 2019.[ii]

In the out-turn, the fund has performed slightly ahead of the Investment Association Global Equity Income sector, which includes similar global equity income strategies, but behind its comparator benchmark, the MSCI World. We expect the portfolio to lag in a strong market, as aggregate investor preference moves away from stable, steadily growing businesses in search of increased returns. The companies we invest in are not really the sort to get the pulse raised too much day-to-day, being more designed to deliver good risk-adjusted returns in the long run. Nonetheless, their performance has been affected by trends reflective of the broader market environment, exemplified by our core sectors – consumer goods, healthcare, and information technology. These three sectors make up 70% of the fund's portfolio, with the remainder being in business service companies and some selected industrials.

Diverging fortunes

Companies within our 'big three' sectors all exhibit asset light, cash generative, and steady growth characteristics. These are base requirements that fit with our aim of delivering a steady and growing income stream. But, taking data up until the end of October, their performance has been divergent.

Information Technology

Starting with the bright light, the IT sector has been the standout performer for the fund and has driven the wider market upwards as well. The fund's holdings in the sector have outperformed those in the market so far this year. The sector contains a wide range of technology-related hardware, software and service businesses. For the fund these range from consultancies Accenture and Capgemini to those at the nexus of hardware and software like Cisco and Hexagon.

Large IT companies servicing global business have been en vogue, with pre-pandemic trends accelerated by the shove of many of our working and social lives into the online realm thanks to Covid-19. For example, Microsoft and Oracle's stocks both delivered +50% total return this year in sterling to the end of October. This market action is being backed by real-world results; in the most recent quarter Microsoft's revenues increased by 22% year-on-year, thanks in no small part to its cloud business growing by 29%, and its profit margin also expanded. Database firm Oracle's growth has been steadier, with profit up in the mid-single digits, but it started from a cheaper price in our estimation. It seems well placed to service the database and enterprise management needs of businesses around the world, particularly as it moves its services to the cloud.

Corporate digitisation, through cloud adoption, networking and simulation, is a huge secular trend. Hexagon, which has its roots in technologies for measurement and analysis in geospatial applications, is aiming to create 'smart digital realities'. By combining software, hardware and measurement of the environment, they enable the building of 'digital twins' that help customers to model and manage their operations in real time, such as in industrial facilities. In the consumer world, similar efforts to digitalise everything have been dubbed the 'metaverse', with Facebook recently changing its holding company name to Meta in homage to the fundamental online shift being perceived. The corporate metaverse presents a similar science-fiction-becomes-reality opportunity.

Healthcare

Companies utilising the next generation of information technology are found in all sectors. Siemens Healthineers, a global market leader in medical imaging, diagnostics and treatment, is aiming to technologically connect the different parts of diagnosis and treatment pathways. This is most notable in oncology, and it has just acquired the global market leader in radiotherapy equipment, Varian. The aim is to use connectivity across diagnostics, imaging and treatment, combined with artificial intelligence, to automate routine processes and to enable healthcare practitioners to be more efficient. The US is short of 15,000 radiologists according to the company, highlighting the need for efficient use of healthcare system resources.

The healthcare sector makes up about 20% of the Evenlode Global Income portfolio, but like the IT sector, there is a huge diversity of businesses within that allocation. To the end of October the sector overall had been strong in absolute terms, delivering +17% for the fund, although relative to the market that was about neutral.

However, not all medical hardware companies have experienced the same market outperformance. Medtronic, which predominantly makes smaller pieces of medical technology such as insulin pumps, pacemakers and stents, has lagged behind Siemens despite the resumption of elective surgery procedures following lockdown. This underperformance has been attributed to a recall of a heart implant device used during heart transplants and an extension to a medical trial for a kidney/hypertension device. However, the long-term prospects for Medtronic's very diversified portfolio of life-changing, and in many cases life-saving, products are good. Access to medical devices is improving globally and an aging developed market population is increasing the proportion of government budgets devoted to healthcare.

Elsewhere in the sector pharmaceutical firms like Roche and services companies such as Quest Diagnostics and Sonic Healthcare have been performing solidly on a fundamental basis, helped on by an increase in diagnostic testing for Covid-19.

Consumer Goods

The consumer goods sector has gone almost exactly nowhere in total return terms for the fund this year. In the context of continued steady revenue growth, there's clearly a narrative affecting share price performance. Input cost inflation and its impact on margins is, in short, that narrative.

At nearly 30% of the fund, the performance of the sector is of obvious interest to us and our co-investors. In response to the relative underperformance, we remind ourselves that it is our task to separate long-term prospects for these (and all) businesses from the short-term narrative. We wrote in detail about some of the dynamics at individual companies last month[iii], and on the valuation opportunity that it is presenting in September[iv], so we won't dwell on the sector too long here. But at the risk of belabouring the point, we are starting to witness these firms' ability to pass prices through to consumers, and in the long term the prospects for steady revenue, profit and cash flow growth remain intact.

Bringing it together

The portfolio has seen robust revenue and profit performance through 2020 and 2021. Importantly, the current valuations of our portfolio companies are compelling in absolute terms[v] but particularly in the context of a market that continues to rise. Looking to the future, our focus remains on managing fundamental risks, through solid balance sheet management, strong cash flows and competitive positions, and on managing market risks, through our valuation discipline.

As stated earlier, making predictions is a tricky business. As we look to the future, some of the factors that are currently causing supply chain disruption and demand spikes will likely abate, but other trends will certainly emerge. We select a diversified portfolio of companies across a range of industries and geographies with the financial resources to absorb negative short-term impacts and make the most of longer-term shifts in demand. In doing so the portfolio is well-prepared for the worst, but also ready for the best of what might happen.

Ben, Chris, Bethan and the Evenlode team
22nd November 2021

Please note, these views represent the opinions of the Evenlode Team as of 22nd November 2021 and do not constitute investment advice.

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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. Evenlode Investment Management Limited is authorised and regulated by the Financial Conduct Authority, No. 767844.

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[i] To 17th November 2021
[ii] B Acc shares. The Dublin-based Evenlode Global Dividend fund (I Acc GBP shares) was up 20.1% from the end of 2020 and 25.1% since the end of 2019 in sterling terms.
[iii] https://evenlodeinvestment.com/news/consumer-brands
[iv] https://evenlodeinvestment.com/news/values-redux
[v] We estimate valuations using a discounted cash flow valuation model and examining other metrics such as free cash flow yields. As ever we're happy to discuss in detail with interested readers, do get in touch.