December 2018

Monthly Commentary

Pan Europe update

- Pan-European equities fell in November amid trade tension and politics
- GDP eased to its slowest in four years
- Portfolio movement reflects confidence in companies with long-term growth prospects

Market overview

Pan-European equities ended lower in November. Early on, stocks rebounded from the previous month's lows, propelled by Wall Street's rise following the US mid-term elections. Subsequently, the unstable global political climate failed to sustain investors' confidence. The Apec summit did not manage to issue a joint communiqué for the first time in its 29-year history, while Europe faced a series of setbacks, including a string of Cabinet-level resignations in the UK government over Brexit, the Budget standoff between Rome and Brussels, and poor results at regional elections that forced Chancellor Angela Merkel to step down when her current term ends.

On the economic front, November inflation slowed to 2%, in line with expectations. This also correlated to lower crude oil prices. Eurozone manufacturing and services sectors contracted and third-quarter GDP continued to ease to its slowest in four years, while employment also decelerated. In the UK, third-quarter GDP expanded by 0.6%, in line with expectations. Although services activity slowed, it continued to contribute the most to growth, while manufacturing output grew for the first time this year. Nevertheless, business confidence slid to its lowest in nine years amid lingering uncertainty stemming from Brexit. Inflation stayed unchanged at 2.4% despite expectations for an increase. Meanwhile, September data showed a mild deterioration in unemployment, even though net pay accelerated to its fastest in nearly a decade.

Looking ahead

We are cautiously optimistic about the prospects for European equities. While conscious of elevated valuations, Europe is still more attractively valued than many other developed markets. A source of volatility is geopolitics, including US/China trade tensions, ongoing Brexit negotiations and Italian budgetary concerns. However, such conditions can create buying opportunities as investors overreact to the headlines. We continue to take a careful and measured approach to capital allocation, favouring companies whose market positions, competitive advantages and balance sheets afford them the best opportunity to prosper over the longer term. We take comfort from the fact that this approach has stood us in good stead during some more difficult periods so far.

What we've been busy with

In November, we exited UBS, in order to reallocate capital into other more compelling opportunities. We pared **Aveva** and **British American Tobacco**, and topped up **Nemetschek**, **Schoeller-Bleckmann** and **Temenos**, taking advantage of recent share price weaknesses. We saw compelling long-term growth prospects for **Amplifon** and **Atlas Copco**, and added to these holdings too. We also topped up **Hannover Re** and **Deutsche Boerse**, as these provide diversification to the overall portfolio.

Note: Any changes refer to those of our model portfolio, which is the basis for actual portfolios we manage that have similar investment objectives. However, there might be minor variations, so the comments may not apply to all portfolios.

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Corporate News

Consumer: French cosmetics and beauty products giant **L'Oreal**'s share price rose after posting better sales for the first nine months and Italian beverage firm **Davide Campari-Milano**'s sales grew by 8.9%, capitalising on healthy sales in the US and Europe with their orange coloured spirit Aperol. However, German chemical and consumer company **Henkel**'s sales missed estimates across all divisions, but the company remained optimistic in its forecast for the year. **Unilever** named Alan Jope, head of its beauty and personal-care division, as its new CEO. He will replace Paul Polman in 2019.

Energy: Oilfield equipment maker **Schoeller-Bleckmann** posted good results, driven by good backlog development and healthy margins.

Financials: German reinsurance giant **Hannover Re** targeted profits for 2019 at a conservative €1.1 billion, despite the company's results exceeding expectations.

Healthcare: German drugmaker **Bayer** will cut 12,000 jobs globally as part of a major cost-reduction programme. The company also plans to divest its animal-health division, as well as several of its consumer brands. The efforts are expected to result in €2.6 billion in yearly savings from 2022, but it will incur €4.4 billion in one-off costs.

Industrials: French pre-paid corporate services firm **Edenred** bought CSI, a corporate payments business in the US, for $600 million. The business is high margin and should give Edenred better pricing power.

Scotland-headquartered engineering firm **Weir Group** posted soft third-quarter results with oil & gas revenues down about 10% in the second-half of 2018: this implied a lower operating profit margin compared to the first-half.

UK-based **Experian** posted solid first-half results with robust organic revenue growth and an earnings upgrade for the full year. The decision analytics division performed well, with the launch of its big-data analytics platform. Consumer service was helped by an improvement in the UK. However, the forecast remained unchanged due to the foreign-exchange impact from Brazil and a higher tax rate. Nevertheless, the company continued to show good momentum.

Technology: Spain's **Amadeus IT Group**, is being investigated by the European Union over alleged price-fixing. However, management remained confident that its business practices meet regulatory requirements.

We hold the companies highlighted.

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