Q1 2019

Commentary

Aberdeen Standard Investments

Global Equity Unconstrained

Market review

Global equities made strong gains during the first quarter of 2019 as optimism prevailed after a gruelling fourth quarter.

Worries over slowing global growth, the US/China trade war and the impact of rising US interest rates caused the previous rout. These concerns subsequently abated. In particular, the US Federal Reserve's (Fed) adoption of a more patient approach to further rate hikes reassured investors. Indeed, bond markets expect the Fed's next move will be to cut rates. The US administration's decision not to impose further tariffs on Chinese goods was also encouraging. Investors are now hopeful both sides can strike a deal.

Activity

During the quarter, we built up a position in Canadian gas station and convenience store operator Alimentation Couche-Tard. It is delivering strong sales growth from the successful execution of its strategy, such as the development of a loyalty programme. Microsoft was another purchase, it is a major beneficiary of the shift to Cloud computing and the software-as-a-service (SaaS) model. This is feeding through to improved margins and cashflow as capital expenditure looks to have peaked. Japanese pharmaceutical company Shionogi was another purchase, as we see upside to earnings from its flu treatment being rolled out in US. The business also has an HIV franchise that provides a stable source of sales. Shionogi is set to get a boost from further approvals for its new HIV treatments shortly, which should address challenges its current product is facing.

Martin Marietta Materials was the focus of selling activity. The aggregates company announced revenue guidance that favoured volume over pricing. However, its recent record of revenue growth has disappointed, hence our decision to exit the position. Further selling activity centred on Kraft Heinz. We lost confidence in the ability of the food producer to grow its top line and maintain profit margins in the face of tough competition. Other significant sales included microchip maker Broadcom and computer games publisher Electronics Arts.

Performance

US payment company Worldpay's results were better than expected and it confirmed progress on the integration of a recent merger. We are optimistic about its ability to exceed consensus forecasts on revenue as momentum continues in its core business. This is reinforced by the potential opportunities for further cross-selling. Ctrip.com, the online travel agent, announced strong earnings. More importantly, profit-margin guidance was ahead of investors' expectations. We continue to see robust revenue growth and with higher margins there is further upside to earnings estimates. The US fast-food restaurant operator Restaurant Brands released a positive trading statement with improved performance from its Tim Horton brand. The strategy to turnaround the underperforming brand appears to be working. Other holdings that did well included Equinix and Marvell Technology.

On the downside, GrubHub was weak as investors grew concerned about increased competition from UberEats and Amazon. However, the business is the market-leading online-food ordering and delivery company in the US. We retain confidence in the business, but are monitoring the issue closely. Japan's largest petroleum and metals conglomerate JXTG was de-rated. The markdown resulted from concerns about its domestic refining margins being squeezed because of higher input prices and weaker end-market demand. Finally, US health insurer UnitedHealth Group suffered from political moves ahead of the 2020 US presidential cycle. Democratic Party proposals to alter the structure of the health-insurance market would hit the company's profitability. We believe the chances of the proposed legislation passing are slim.

Outlook and Strategy

Earnings estimates remain solid. However, there are numerous headwinds, from the US-China trade dispute to politics in Europe. The resolution of any of these would provide a boost to sentiment. Against this backdrop, we believe earnings rather than valuations will be the primary driver of share prices. We believe our fundamental bottom-up investment approach remains the best way to generate robust long-term returns. We therefore continue to shape the strategy with as much stock-specific risk as possible. This should stand us in good stead in the event of market weakness.

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