# RESPONSIBLE AND SUSTAINABLE EUROPEAN EQUITY FUND

## COMMENTARY FOR QUARTER TO END DECEMBER 2021

### PERFORMANCE

| | 3 Months | 6 Months | 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|---|---|
| Fund Performance (B Class) | 1.77% | 3.81% | 17.52% | 42.92% | 47.23% | 185.96% |
| FTSE World Europe ex UK TR GBP | 5.06% | 5.85% | 17.40% | 53.60% | 63.45% | 204.48% |
| IA Europe ex UK | 3.77% | 5.44% | 15.65% | 53.88% | 58.74% | 201.73% |
| Sector Quartile | 4 | 4 | 2 | 4 | 4 | 3 |

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested.

### REVIEW

European equities rose in the fourth quarter. Concerns about the high transmissibility of the new Covid-19 variant Omicron were offset by low hospitalisation rates and fairly resilient economic data. While the economy remained in expansionary territory, composite PMI readings showed growth slowing to a pace not seen since the first quarter of the year.

Highly volatile energy prices contributed to increasingly entrenched inflation. The European Central Bank was eventually forced to concede that the inflationary outlook required it to start scaling back its bond purchase programme, aiming to conclude it in early 2022. With rising interest rates in other economies, Europe may not be far behind, posing a challenge to rate-sensitive growth stocks. Such stocks dominated global equity markets for the early part of the quarter, but, with central banks around the world turning marginally more hawkish, value stocks seemed to be taking global market leadership towards the latter part of the quarter. This effect was less pronounced within European equity markets in particular, as European equities tend to trade on lower valuations than US equities. European equities nevertheless seem to be entering 2022 in a very different market context from the one that prevailed in 2021.

### PERFORMANCE & ACTIVITY

The Fund generated a total return of 1.8% in the final quarter of 2021, underperforming its FTSE World Europe ex UK benchmark, which returned 5.1%. It is worth noting, however, that period of underperformance seems to have been punctuated by outperformance in the final month of the year, in which the fund returned 4.6% against the benchmark's 3.8%.

The Fund had no exposure to the Energy sector, on sustainability grounds, nor to the Technology sector, on valuation grounds – both of these sectors posted particularly strong returns in October. In November, the Fund suffered from being overweight some of the countries more badly hit by the current wave of Covid-19 infections, such as Spain. It was not until December that the market dynamic shifted in favour of the Fund's allocation, with value-heavy areas of the market, like France and Industrials, helping the Fund recover some of the losses sustained in the early part of the quarter. Otherwise, market returns over the quarter were generally concentrated among large caps, which the Fund is underweight, while losses were concentrated among small-caps, which the Fund is overweight. The Fund also suffered from its underweight allocation to Switzerland, whose Health Care heavy equity market generated strong returns over a quarter dominated by fears over the new Covid-19 variant.

Merck, Nokia, and Veolia made the strongest contributions to relative performance. Merck raised full-year guidance, following very strong results from its Life Science division, driven by Covid-19 related business. Nokia delivered strong third-quarter results, with consensus-beating profit driven by its Mobile Networks segment despite a large increase in spending on research and development. It was particularly pleasing to see Nokia return to delivering very strong free cash flow generation for the first time in years. Veolia benefited from edging closer to the completion of its merger with Suez, which would create the world's top environmental services company, improving margins, geographic diversification, and overall market share considerably. Among the quarter's main detractors from relative performance were holdings in Draegerwekrk, PostNL, and Bank of Ireland.

We increased exposure to Financials by adding to names like Banco Santander, Mapfre, ING Groep, and ABN Amro. We took profits from Vivendi after a run of very good performance, and also sold out of Billerudkorsnas, Wolters Kluwer, and Rockwool International, none of which seemed compelling investment propositions at prevailing valuations.

## OUTLOOK

We continue to believe that value cyclicals, such as banks and insurance companies, remain attractive. We also believe that value defensives are more attractive than growth stocks under current market conditions, which tends to keep us out of technology and consumer staples. As we move into 2022, it seems like equity markets in general could be on the cusp of a rotation away from the growth-focused markets driven by multiple expansion of recent years. If economic growth remains benign and interest rates continue to rise, this should benefit “old economy” companies with profitable near-term activities. Such companies, after years of underperformance in the market, are trading at low valuations, and should be able to generate returns both from their underlying economic activity and from rerating to higher valuations.

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