R&S European Equity Fund

Q1 2023 Commentary

Performance with principles®

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	6.9%	24.3%	10.0%	71.9%	41.2%	142.6%
FTSE World Europe ex UK TR GBP	8.6%	21.7%	8.7%	56.2%	47.4%	137.4%
IA Europe Excluding UK	8.1%	21.7%	6.6%	55.2%	39.2%	125.0%
Sector Quartile	3	1	1	1	3	1

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

MARKET REVIEW

European equities gained ground during the first quarter of 2023, but their robust headline performance disguised episodes of volatility. At the start of the period, concerns that a weakening global economy would prompt central banks to pivot away from tightening monetary policy sooner than expected saw equities extend their Q4 2022 rally. These gains were reinforced by signs that inflation in most major economies, aside from the UK, had peaked, while a mild winter helped drive energy prices lower, even though the war in Ukraine continued to show no signs of ending. Market direction was abruptly reversed in March when the failures of Silicon Valley Bank and Credit Suisse prompted fears of a much-wider banking crisis. Authorities in the US and Europe quickly acted to alleviate these concerns, but market sentiment maintained a risk-off tone for the rest of the quarter. The European Central Bank (ECB) continued to raise interest rates over the reporting period, which reached 3.0%, but ECB President, Christine Lagarde, hinted that future interest rate decisions would depend on the economic environment even though inflation remains remained high.

PERFORMANCE & ACTIVITY

The Fund started the year with a solid quarterly return of 6.9%, but underperformed its FTSE World Europe ex UK TR GBP benchmark, which returned 8.6%, with all of the underperformance taking place in March. While this performance placed the Fund in the third quartile over the quarter against the IA Europe Excluding UK peer group, the Fund continues to sit in the top quartile over one and three years.

A reversal of the recent outperformance of value shares versus growth proved to be a headwind for the Fund, as investors began to fear a cyclical downturn and lower interest rate expectations supported 'growth' areas of the market. However, with the valuation differential between value and growth remaining wide we continue to maintain our overweight value position. At a sector level, stock selection was a drag on performance over the period. While the Fund's overweight exposure to financials has been a significant benefit to performance over the last year, this was partially dampened in March as the sector became caught in the spill-over from the banking sector's woes. We continue to believe banks offer ongoing value, particularly the retail banks which are well-capitalised, and retain our overweight exposure. The Fund's underweight technology exposure also detracted from performance, due to the outperformance of growth stocks over the period, as did its underweight consumer discretionary position. On the positive side, the Fund's telecommunications, health care and industrial holdings added value. Nil exposure to the energy sector, which is not held on Responsible and Sustainable grounds, was also a significant positive for relative performance.

At the stock level, a mix of cyclicals, including media group Publicis Groupe (France) and delivery company Deutsche Post (Germany), and defensive holdings, such as telecom Orange (France), alongside renewable energy product provider Rexel (France) and retail bank Banco Santander (Spain) all made notable contributions. Less successful holdings this quarter were Swedish paper manufacturer Billerud, German logistics company Hamburger Hafen, real estate investment trust Covivio, German insurance group Talanx and Swedish appliance manufacturer Electrolux.

We made few changes to the Fund over the quarter, maintaining its balance between cyclicals and defensives. In terms of transactions, we raised the Fund's health care exposure although this still remains underweight versus the benchmark, and we reduced its exposure to insurers. We also topped up our position in Dutch multinational conglomerate Philips. While the repercussions surrounding the recall of its sleep apnea product continue, we believe it is making progress on settling claims and feel the negative sentiment affecting its share price has been overdone.

OUTLOOK

Europe continues to face multiple economic headwinds, including the war in Ukraine, high inflation and rising interest rates, yet we believe a large part of the damage from these issues will be offset by ongoing employment resilience and China's post-Covid reopening. Consequently, we believe any forthcoming slowdown should not be as severe as generally forecast and economies are coping well with higher interest rates so far. Q4 earnings saw a spate of positive revisions, notably among value sectors, while growth earnings continue to be weighed down by higher borrowing costs and a retraction in consumer demand. Overall, we continue to believe that 'value' stocks and sectors stand at a meaningful discount to the market and expect to remain positioned towards deep value. The Fund remains overweight towards European retail banks which we believe should be resilient in the face of banking failures driven by company specific factors. Given the uncertain economic and investment market outlook we will look to maintain a balance between defensive, interest rate sensitive and cyclical areas of the market.