This is a marketing communication. Please refer to the prospectus of the UCITS and to the KIID / KID before making any final investment decisions.

FUND COMMENTARY – Q3 2023

Threadneedle (Lux) Global Equity Income

Jonathan Crown
Fund Manager
Since: 23/10/2018

Fund Information

You are investing in a fund that is actively managed in reference to the benchmark below. Please refer to the Prospectus and KIID for the Fund objective.

Fund Benchmark: MSCI ACWI Index

Inception Date: 23/10/2018

Fund Currency: USD

Fund Domicile: Luxembourg

SFDR: Article 8*

Summary

- Global equities declined over the quarter.
- Gross of fees, the fund underperformed its benchmark.
- New holdings over the period included ConocoPhillips, Baxter International and Saint-Gobain.

Market Background

The MSCI All-Country World index (ACWI) declined 2.4% in local currencies in the third quarter (Q3).

Equity markets were initially boosted by better-than-expected corporate earnings and hopes that the world economy could navigate a ‘soft landing’. However, as the quarter progressed, investor sentiment weakened amid concerns around China’s faltering economic recovery and the country’s indebted property sector, despite Beijing announcing stimulus measures. And while headline inflation continued to ease in major economies, core inflation (which excludes volatile components such as food and energy prices) remained elevated and labour markets remained tight. This stoked fears that central banks may not lower interest rates as quickly as previously anticipated, which negatively impacted equities, particularly for growth-oriented companies.

US stocks were hurt by fears of elevated interest rates due to the market’s sizeable exposure to high-growth names. After hiking rates by 25 basis points (bps) in July, the Federal Reserve held fire in September. However, markets interpreted this as a ‘hawkish pause’ as the central bank’s closely watched ‘dot-plot’ projections indicated one further hike this year. Policymakers also revised down the number of expected rate cuts in 2024. Resilient economic and labour-market data also stoked concerns that rates would stay ‘higher for longer’. Treasury yields jumped, which added to the risk-off mood, as did strikes by auto union workers and the prospect of a government shutdown over a federal funding dispute. Many high-growth tech stocks that led the rally earlier in the year underperformed as investors pivoted to value stocks amid the shifting interest-rate narrative.

European equities underperformed in Q3 amid weak economic data from the region and from China – a key export destination. The European Central Bank raised rates by 50 bps over the quarter but signalled in September that it had likely finished with policy tightening. UK equities bounced back from their underperformance earlier in the year. The UK inflation story appeared to take a positive turn, which most likely influenced the Bank of England’s unexpected decision in September to leave interest rates unchanged for the first time in almost two years. Optimism that interest rates in the UK may have peaked caused the pound to fall, adding further support for overseas earners in the UK stock market. Given its sizeable exposure to the energy sector, the FTSE All-Share also benefited from surging oil prices after Saudi Arabia and Russia announced further extensions to supply cuts.

Japanese equities posted another positive return in Q3, albeit at a slower pace than in the first half of the year. The country’s export-heavy market was supported by a weaker yen. The Bank of Japan largely maintained its ultra-loose monetary policy stance, although, in July, it did unexpectedly announce an effective widening of the range in which 10-year Japanese government bond yields can trade. Emerging markets (EMs) ended Q3 slightly lower, hurt by rising Treasury yields, the US interest-rate outlook and concerns around China’s economic growth.

In local-currency terms, the UK performed best, while Japan also ended Q3 in positive territory. EMs recorded a negative return but outperformed the ACWI. Europe ex UK stood as the worst performer, with the US also underperforming.

At the sector level, energy was by far the top performer, fuelled by rising oil prices. Utilities fared the worst; higher interest rates can negatively impact these stocks due to the higher debt loads of companies in the sector relative to those in other industries. Real estate, another sector often hurt by higher rates, also performed poorly, as did consumer staples.

*The Fund is categorised an Article 8 under the EU Regulation 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR) and promote environmental or social characteristics as an objective. Please refer to www.columbiathreadneedle.co.uk for further disclosures. The decision to invest in the promoted fund should take into account all the characteristics or objectives of the promoted fund as described in its prospectus.

Performance

12M Rolling Period Return in (USD) - as at 30 September 2023

	09/22-09/23	09/21-09/22	09/20-09/21	09/19-09/20	09/18-09/19	09/17-09/18	09/16-09/17	09/15-09/16	09/14-09/15	09/13-09/14
Fund (Gross) %	18.18	-15.69	27.15	-2.31	3.25	3.81	15.08	12.85	-4.62	5.54
Index (Gross) %	21.41	-20.29	27.98	11.00	1.95	10.35	19.29	12.60	-6.16	11.89

Source: Columbia Threadneedle Investments as at 30/09/2023. Gross of fee fund returns are time-weighted rates of return net of commissions transactions costs and non-reclaimable taxes on dividends interest and capital gains using pricing of investments which is either the last traded price or a bid basis. Cash flows are factored as of the end of the day and exclude entry and exit charges. Index returns include capital gains and assume reinvestment of any income. The index does not include fees or charges and you cannot invest directly in it. The return of your investment may change as a result of currency fluctuations if your investment is made in a currency other than that used in the past performance calculation.
Past performance does not predict future returns and future returns are not guaranteed.

The past performance information for the period prior to 23 October 2018 is from the Global Equity Income Fund (a UK authorised UCITS fund launched on 27 June 2007), which merged into this Fund on 24 November 2018.

For detailed information on Fund Changes please see Significant Events - Threadneedle (Lux) Funds PDF available on www.columbiathreadneedle.com/en/changes

Gross of fees, the fund underperformed its benchmark over the quarter. This was due to unfavourable security selection, particularly in industrials and financials, though choices in energy were helpful. Sector allocation was positive, aided by the overweight in energy and the underweight in technology.

At the stock level, detractors included Experian, which was impacted by the sell-off in high-growth names. The stock was also hurt by concerns that higher-for-longer interest rates will weigh on demand for the company’s credit scoring services as consumers refrain from borrowing. However, our investment thesis remains intact.

Siemens was also a drag on relative returns as the German industrial giant missed quarterly profit forecasts, citing weaker demand owing to a sluggish recovery in China and customers in several regions running down the inventories built up in 2022 amid concern about potential shortages. However, the company’s management reaffirmed forecasts for full-year growth in overall revenues and earnings. Siemens boasts a global presence and benefits from significant economies of scale. We favour the company for its focus on technology and innovation, and we believe it stands to benefit from growing demand for automation and digitisation as factories look to improve efficiency. Siemens also has attractive exposure to energy management in the building industry.

On the other side, the zero weight in Apple proved beneficial in a difficult quarter for the stock as investors pivoted away from high-growth names.

The holding in TotalEnergies also added value in a strong quarter for oil prices. Shares were further boosted after the company’s investor day in September, when management announced plans to increase shareholder returns to levels exceeding those of some European peers. TotalEnergies has significantly strengthened its cashflows and balance sheet thanks to higher oil and gas prices over the last two years. The company has used these funds to invest in renewables and low-carbon energy, and it has gained a head start over its peers in doing so. In our view, TotalEnergies is well positioned to become a leading player in the transition to decarbonisation.

Activity

New positions included ConocoPhillips, Baxter International and Saint-Gobain.

ConocoPhillips is one of the best-managed oil and gas businesses, with significant reserves, a low cost base and a diversified asset base with a low rate of decline. These factors, along with the firm’s robust balance sheet, mean that Conoco is well positioned to withstand periods of volatile oil prices. The firm also boasts a global presence, large scale and a solid M&A track record. In addition, its capable management team has a shareholder-friendly approach with a history of consistent payouts.

Baxter makes a broad range of essential healthcare products used by hospitals, kidney dialysis centres, nursing homes, rehabilitation centres, doctors’ offices and research laboratories. The shares are attractively valued following a period of underperformance amid concerns around the company’s past execution, along with leverage, inflation and supply-chain pressures. Although uncertainties persist in the near term, we hold conviction in the stock. Furthermore, we expect Baxter to experience higher demand for its consumable products as the number of medical procedures increases. We are also positive about management’s greater focus on sales growth and margin expansion.

Saint-Gobain designs, manufactures and distributes materials and solutions for construction, mobility, healthcare and other industrial applications. The firm offers a unique range of products and services for all areas of the construction industry, giving it a strong and growing competitive edge. Its international presence allows it to offer solutions for new builds and the renovation of existing buildings that are tailored to the specific needs of its local markets. The firm is well positioned to benefit from the upcoming wave of European renovation as new decarbonisation regulations come into effect. Saint-Gobain should also continue to make acquisitions to strengthen its portfolio in terms of geography, product and margins.

To help fund these purchases, we sold out of Novartis following recent strong performance. We also exited Sandvik and Ping An Insurance as we believe there may be better opportunities elsewhere.

Outlook

We are now likely living through an extended period of higher inflation, driven by deglobalisation, the energy transition and unfavourable demographics rooted in a rising dependency ratio. In this environment, we think many businesses will have to shift their capital return expectations. We are adjusting our expectations to this new normal with the aim of avoiding companies with unsustainable dividend targets.

We believe resilient free cashflow margins will be vital in identifying sustainable dividend growers. Consequently, we will focus on ensuring our portfolio companies have pricing power and an ability to manage cost structures and capital investments while operating with reasonable debt loads. This discipline is becoming more important than ever, with dividend sustainability more greatly prized in an inflationary environment.

The return of inflation has only reinforced our preference for companies that can offer a blend of sustainable income and growth; we believe this is the best approach for total returns through the cycle. To manage risk, the fund has balanced exposure to different sources of yield to support a stable income profile across market cycles.

Key Risks

The value of investments can fall as well as rise and investors might not get back the sum originally invested.

Where investments are in assets that are denominated in multiple currencies, or currencies other than your own, changes in exchange rates may affect the value of the investments.

The investment policy of the fund allows it to invest in derivatives for the purposes of reducing risk or minimising the cost of transactions.

The fund may exhibit significant price volatility.

All the risks currently identified as being applicable to the fund are set out in the “Risk Factors” section of the Prospectus.

Please read the Key Investor Information Document and the Fund Prospectus if considering investing.

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