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April monthly commentary

May 10, 2022

The reality of higher interest rates, persistent inflation, and more mixed economic updates, all weighed on equity market performance in April. Most exposed were US markets which meaningfully underperformed given their greater exposure to more rate-sensitive 'growth equities'.

To illustrate the point, the NASDAQ posted its worst monthly performance since 2008, down 13%. The S&P500 was also very weak, down 8.8%. In contrast, Europe held up reasonably well. The UK FTSE was up 0.4% while the French CAC and German DAX were down only 1.9% and 2.2%, respectively. Asia was weak with the Nikkei225 down 3.5%, while COVID lockdowns saw China's market down 6.3%.

There was also meaningful divergence in performance at a sector level. Staples finished up 0.5% while Utilities and Healthcare were down 3.7% and 4.7%, respectively. Energy was a strong performer, down only 1.5%, as supply issues kept gas/oil prices elevated. In contrast, Communications, Discretionary, and IT were all down more than 12%. While it is difficult to determine how much of this can be attributed to the macro backdrop, a series of disappointing results didn't help. For example, AMZN proved it isn't immune to inflation, as higher logistics/fuel prices saw Q1 profits drop 60%.

Indeed, one of the biggest considerations in determining the path of equities is the inflation backdrop. While we don't have the answer, what we're observing is many companies flagging more price rises in coming months. From Unilever, "We expect to restore margin through pricing", from Henkel, "[Stronger FY organic growth], mainly due to passing on higher costs as higher price", and from US-based Packaging Corp, "we expect higher prices in our packaging segment as we implement prices increases".

> *Even in Japan, where inflation is less pressing, the largest labour confederation, RENGO, has demanded a 4% wage boost.*

At the same time, calls for higher wages are growing louder, raising the risks of 1970s era wage-price spiral inflation taking hold. For example, the UK's largest union, Unison, recently urged the British government "to fund above-inflation pay rises across the public sector". Likewise, the UK's Royal College of Nursing has called for a "5% pay rise above inflation".

In this context, yields on 10-yr US treasuries increased by 60bps to close at 2.93%. The resulting equity market jitters saw VIX spike 13 points to close at 33. The AUD fell 5.6% against the USD while the Bloomberg Commodity Index and WTI were both up almost 5%.

US-based healthcare behemoth Johnson & Johnson was one of the Fund's biggest contributors with its more defensive earnings, reasonable valuation, and a very strong balance sheet buffering it against market weakness. We continue to expect these attributes to be well rewarded.

The fund recently gained exposure to Netherlands-based life insurer, NN Group. As one of Europe's largest life insurers it has limited exposure to economic conditions and upside risk to interest rates. Additionally, given NN's solid balance sheet (~2x regulatory capital), a history of strong shareholder returns (~10% returned per year via dividends/buybacks) and a very attractive valuation (0.45x P/BV), we think NN offers good upside at current prices.