TALARIA

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February monthly commentary

March 11, 2022

Acknowledging the terrible human cost of what's going on in Ukraine, we also note that this war in Europe was the key driver of equity market volatility in February.

While most global indices fell during the month, regional performance was seemingly correlated with physical proximity to Ukraine. Europe underperformed during the month with the German DAX hardest hit, down 6.5%, followed by the French CAC, down 4.9%. The UK FTSE showed some resilience, remaining flat over the month. US markets were also lower with the S&P500 and NASDAQ both down 3.1% and 3.4%, respectively. Asian markets fared a little better with the Nikkei 225 down 1.8% and the Shanghai Composite up 3%.

Relative performance also varied considerably at a sector level. Energy was the standout, up 4.5% as escalating fears around oil supply saw WTI rally by 8.4%. Commodity price inflation on similar supply concerns also helped Materials finish up 1.6%. Broader risk-off sentiment saw Consumer stocks fall by 4.4%, while defensive sectors Staples, Utilities and Healthcare fared a lot better, closing down less than 1%. However, the surprise was weakness in Telco and IT which fell 5.4% and 4.8% respectively, despite usually benefitting from risk-aversion. The ongoing growth/value rotation and disappointing results (e.g. Facebook) contributed to this.

> *The war in Ukraine will undoubtedly have meaningful geopolitical and economic ramifications for years.*

However, the reality is that the path of equity markets will continue to be determined by 1) the stubbornness of inflation, 2) the evolution of interest rates and 3) the degree of weakness in leading economic indicators.

On these, we would note that inflation is at a 40-year high (and has likely been supercharged further by hostilities), central banks globally are shifting to a more hawkish policy setting, and leading economic indicators have peaked and are moderating fast. For example, the US consumer's free cash flows have fallen dramatically in recent months (surging food and energy costs) and housing affordability is now worse than just before the GFC. Unsurprisingly, consumer confidence is now lower than at the onset of COVID, which matters when ~68% of US GDP is driven by consumer spending.

The AUD was stronger against the USD. VIX jumped 5.32 points to close just above 30 while 10yr US Treasury yields were also up, reaching an intramonth high above 2%, before finishing at 1.83% (up 4bps since start of February).

Our holding in US-based advertising agency, Omnicom was the biggest contributor to performance. The shares rallied following a good set of results which included strong top-line performance (>10% organic) and margins at record levels. Guidance was also encouraging (+5% organic sales, record margins to be maintained) and the company re-iterated their commitment to returning cash to shareholders.

The fund recently gained exposure to Japanese telecommunications company, NTT. NTT occupies a dominant position in one of the most profitable telco markets globally (>40% share), led by a strong management team who have demonstrated good cost discipline. For example, despite NTT's Mobile ARPU falling ~20% since 2012, Mobile EBIT is up! We were also impressed by NTT's cash generation abilities and capital allocation strategy which has contributed to EPS growing by ~170% since 2012. Encouragingly, this momentum is set to continue with NTT targeting FY23 EPS of ¥370 (~20% above current levels) thanks to more cost-cutting and buybacks. Trading on a prospective P/E of 9x (based on FY23 EPS targets), the share is good value.