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January monthly commentary

February 11, 2022

January was a difficult month for equity markets and a telling one. The month demonstrated just how sensitive or vulnerable equity markets are to the expectation of rising interest rates. The most extreme examples of this were in speculative issuers, namely loss-making Tech and ETFs exposed to early stage "disruptors".

As we have said for some time, too much energy is spent on forecasting and not enough spent on thinking about positioning. We continue to believe overexposure to US equities and Tech means investors face a high degree of concentration risk. We also continue to find good opportunities to deploy capital outside of the US and into sectors other than Tech. For example, we recently took advantage of elevated volatility to gain exposure to German adhesives and consumer brands company, Henkel (see below).

At the index level, US markets underperformed, particularly Tech, with the NASDAQ down almost 10% in January. The S&P500 was also materially lower during the month, down 5.3%. In a relative sense, Europe fared a lot better. The German DAX and French CAC fell 2.2% and 2.6%, respectively, while the UK FTSE managed to finish up 1.1%. In contrast, performance in Asia was weak with the Japanese Nikkei225 down 6.2% and China's Shanghai Composite down 7.6%.

At a sector level, the one bright spot was Energy, which finished up 15% as WTI rallied 17%. Constrained OEPC+ supply, geopolitical tensions, underinvestment in new production, and stronger demand recovery have all supported WTI in recent months. Outside of Energy, it was difficult to find much sanctuary. IT and Consumer Discretionary faced the brunt of investors' concerns around rates with both down a massive 11% for the month. Healthcare, Industrials and Telco were also weaker, each down over 8%. Even the more defensive sectors failed to provide much cover with Utilities and Staples down 4.5% and 3.6%, respectively.

Yields on 10-year US government bonds reached an intra-month high of 1.86% in January, before falling back slightly to close at 1.78% and up 27bps for the month. Against this backdrop, VIX rose 7.61 points to 24.83, while the AUD fell 2.7% against the USD despite strength in commodity prices. Along with the rally in oil prices, the Bloomberg Commodity Price index was also stronger, 8.8% for the month.

One of the biggest contributors to performance was German pharmaceutical and life sciences company, Bayer. The stock has performed strongly in recent months, benefiting from upgrades on the back of improving agricultural fundamentals, alongside increased expectations around new drug launches. The stock has also been a beneficiary of its attractive valuation, which the market is more amenable to in the recent rotation from growth to value.

In terms of new holdings, the Fund recently bought exposure to German adhesives and consumer brands company, Henkel. In addition to a solid balance sheet and strong cash generation, Henkel's Adhesives unit is a world-class business (~50% of sales). However, Henkel's other main segment, the struggling Consumer business, comprises of second-tier Laundry/Beauty brands. This business has persistently disappointed and faces stiff competition from major-players P&G, Unilever, and Reckitt. While there is no evidence of an immediate turn-around, the good news is that the valuation now appears to be capturing a lot of this embedded earnings' risk. Hence, given scope for a strong earnings recovery in Adhesives, and the opportunity for more capital management, there is a strong chance Henkel may surprise to the upside over the next few years.