July monthly commentary

August 10, 2022

There was more than a touch of "and with one bound they were free" for equity markets in July. A reversion to US outperformance, Technology outperformance, lower interest rates, and a sense that the US Federal Reserve would conquer inflation with little economic damage done. A further source of optimism was an earnings season free of major disappointment, with outlook statements that did nothing to frighten the horses.

The NASDAQ was the best performing large cap index, up 12.3% in July, with the S&P500 and S&P600 Small Cap Index also posting rises of more than 9% each. In Europe, performance was led by the French CAC, up 8.9%, followed by the German DAX and UK FTSE, both up 5.5% and 3.5%, respectively. Performance in Asia was more mixed. While the Japanese Nikkei225 was up 5.3%, China's Shanghai Composite was down 4.3% as concerns around lockdown fears, regulatory actions against tech giants, and deteriorating property market fundamentals all weighed on sentiment.

At a sector level, outperformance was led by Consumer Discretionary and IT, up a remarkable 15.4% and 13.1%, respectively. Helping deliver this performance was a series of good results from tech giants. Most noticeable amongst these was Amazon, where better than expected sales/ earnings and positive comments about consumer spend habits saw the stock rise 10.4% on results day. Industrials were good performers with the sector up 9.1%, as was Energy, up 6.8%. Defensive sectors such as Staples, Health Care and Telco, lagged, up less than 4%.

Against the backdrop of stronger equity markets, the VIX fell 7 points to close at 21. Yields on 10-year US treasuries were also lower, falling 36bps to close at 2.65%. Commodities were more mixed, with strength in natural gas prices helping the Bloomberg Commodity Price Index rise by 4%, despite the weakness in WTI which fell 7%. Given the mixed commodity backdrop, the AUD was up only 1% against the USD.

French-based catering and voucher business, Sodexo, was one of the Fund's biggest contributors in July. Following a strong Q3 trading update the stock has been well supported, with the business model demonstrating resilience at navigating current headwinds. Organic sales growth in Q3 of ~18% was very strong and now suggests Sodexo may exceed FY guidance. Given the combination of good short-term momentum, ongoing longer term structural tailwinds (I.e. outsource catering), a reasonable balance sheet, and still supportive valuation, we think Sodexo has more upside to offer.

The Fund recently gained exposure to US-based pharmaceutical giant, Gilead Sciences. Gilead has a strong, cash generative franchise in HIV which has enabled it to invest significant amounts in R&D and M&A over the years. This has allowed it to diversify into oncology treatments. The stock also enjoys significant valuation support, trading on a Free Cash Flow Yield of >10%, with a dividend close to 5%. Additionally, based on existing patented cash flows, Gilead's current share price assumes very little outcome from its R&D pipeline. Put another way, we are not paying for any prospective R&D success. Therefore, given limited downside by virtue of its strong cash flows and low starting valuation, we think shareholder outcomes are skewed to the upside.

We constantly emphasise that investors need to consider positioning as well as forecasting. The rally is a rebalancing opportunity for those still heavily overweight US equities, especially large cap. Tech. Anything can happen, but it would be surprising if July's strength signalled an end to the challenges.