Monthly Market Commentary

October saw a sharp rotation in global equity markets, with value stocks, small-caps and equal-weighted indices meaningfully outperforming as investors moved out of growth and AI-exposed sectors.

A series of high-profile IPO delays, intensifying competition and concerns over capacity constraints all prompted a notable reassessment of the AI investment cycle during the month with investors increasingly looking through solid AI-fuelled earnings growth. Instead, focus has shifted to the risks around AI spending commitments (both on and off-Balance Sheet), financing needs and the timing of cash flows.

This dynamic weighed heavily on the Magnificent-7, with investors penalising stocks that failed to deliver on free cash flow (FCF) expectations. Most notably, Google-parent Alphabet fell 12.3% following a disappointing Q3 result in which advertising growth slowed and FCF turned deeply negative, against expectations for break-even. Social media giant Meta also fell 7% after Q3 FCF turned negative, alongside an increase to the lower end of its FY capex guidance and the creation of non-voting shares to facilitate future equity raisings.

In US markets, the NASDAQ bore the brunt of the selling, down 5.3% for the month, while the S&P500 fell 0.93%. Beneath the surface, however, breadth was notably strong, with the S&P500 Equal Weighted Index rising 4.9%, its largest monthly outperformance of its cap-weighted counterpart since April 2009. US small caps also outperformed, with the S&P600 Small Cap Index up 3.1%.

Selling in AI and technology stocks also weighed on Asian markets, with Japan's Nikkei 225 and China's Shanghai Composite falling 5.2% and 6.3% respectively. By contrast, European bourses delivered solid relative performance in local currency terms. Germany's DAX led the way, up 2.5%, benefitting from limited exposure to AI themes and strength in local ERP-software giant SAP. The UK's FTSE rose 1.2% on the back of its outsized exposure to Energy and Health Care. France's CAC40 finished broadly flat, as political uncertainty over the 2027 budget and concerns around stretched public finances weighed on sentiment with 10-year French government bond yields reaching their highest level since 2002.

At a sector level, Communication Services and Information Technology were the two worst performers, down 13.5% and 7.0% respectively, on broad-based AI weakness. Energy was the best performer, up 12.8% on higher oil prices, while defensive sectors Consumer Staples, Health Care and Utilities were also notably stronger, rising 10.5%, 9.8% and 7.8% respectively.

The AUD rose 1.2% against the USD. The Bloomberg Commodity Index fell 0.4%, with a 15.2% rise in WTI largely offset by weakness in precious metals, as gold and silver fell 6.8% and 18.7% respectively. The VIX rose 3 points to close at 19.42, while yields on the US 10-year Treasury finished the month 36bps lower at 4.93%, having reached a high of 5.36% earlier in the month.

US-based reinsurer, Everest Group, water heater manufacturer, A.O. Smith and UK-based distributor, Bunzl were among the top contributors to Fund performance in October, with shares benefitting from the rotation alongside generally good results. There were no notable detractors during the month.

During the month, the Fund initiated a new position in US-based tax preparation specialist H&R Block. While we acknowledge the debate around the potential existential risk AI poses to the business, we believe the shares were acquired at a very compelling valuation (Free Cash Flow yield ~14%). The business also carries no financial risk, benefits from a highly variable cost base and generates strong FCF, almost all of which is returned to shareholders via dividends and buybacks.

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