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October Monthly Commentary

November 15, 2021

After a tricky September for equities, stock markets roared back with a vengeance, pushing many major indices to new all-time highs through October. While bond investors fretted over rising inflation, sending yields higher, equity investors brushed this off, focussing more on the favourable economic backdrop highlighted by robust Q3 results, declining COVID cases and still accommodative fiscal and monetary policies. Sentiment remains to buy-the-dip underpinned by strong corporate and consumer balance sheets, and pent-up demand.

However, equity valuations, especially in the US, are now very full on pretty much every measure. Another way of saying this is that equities are priced to deliver low returns. Moreover, these high ratings are at a time when lead economic indicators are elevated and moderating, rates are low and rising, inflation remains stubborn, taxes are going up and earnings estimates look very optimistic.

This is a complicated picture, and rather than focus on forecasting an outcome, we think it's prudent for investors to consider how they are positioned. We believe many should be rebalancing towards income over capital growth as a component of return, active over passive management, markets outside of the US/Australia, non-tech over tech and value-based investment strategies.

US large caps were the absolute standout performers during the month with the S&P500 and NASDAQ up 6.9% and 7.3%, respectively. Performance in Europe was also strong with the French CAC up 4.8%, followed by the German DAX and UK FTSE, up 2.8% and 2.1%, respectively. While Asian markets were lower with the Nikkei 225 down 1.9%, China was well supported, down only 0.6% despite its growing list of macro challenges.

Performance was also surprisingly strong and broad-based at a sector level with the leaderboard dominated by an odd mix of Financials, Energy, Technology and Consumer Discretionary. All were up more than 6%. Even the defensive sectors, which lagged in a relative sense, delivered good absolute numbers. Staples, Utilities and Health all rose by more than 3%.

The AUD rose 4% against the USD as commodities continued to move higher. The Bloomberg Commodity Index increased 2.6% while WTI was up a very strong 11.4% during the month. Yields on 10yr treasury notes were also higher, rising 6.5bps to finish at 1.55%. VIX was down, falling 6.8 points to close at 16.26.

sodexo

French-based catering and voucher company, Sodexo was one of the biggest contributors to performance during the month. This followed a good set of FY21 results which exceeded both earnings and cash flow guidance and alleviated some of the concerns around the CEO's sudden departure. The company also provided reassuring FY22 EBIT guidance of ~€1bn and re-iterated longer-term sales/margin targets, which if achieved, could see shares rise to ~€100 (~20% upside).

The Fund also recently gained exposure to global PC maker and printing company HP, Inc. After years of disappointing sales and earnings performance, the top-line has started picking up and HP is now guiding to high single digit EPS growth over the next few years. Given its asset light business model, all cash flows are set to be returned to shareholders. Given a supportive valuation (P/E ~10x, dividend yield ~3%) the downside from a stock perspective, also looks manageable. On the flip side, should HP realise its long-term targets, we think there is scope for the stock to trade >$45 (~50% upside).