Sanlam Investments

SVS Sanlam European Equity Fund

Q3 2021 | Quarterly newsletter

Market recap

European equity markets enjoyed a positive quarter with the MSCI Europe ex UK index posting a sterling total return of 0.5% (Source: MSCI, net index return). However, whilst the region made progress over the quarter as a whole, European equities declined in the final month of the period as worries about slowing economic growth and soaring global wholesale energy prices began to weigh on sentiment. Interest rates remained highly accommodative in the euro area, and the ECB was keen to emphasise that the scaling back of monthly asset purchases should not be seen as a taper.

At the sector level, the best performing areas of the market over the quarter included financials, which were buoyed by rising yields. Historically, financials and banks in particular have tended to perform well in a rising yield environment as it enables them to improve the spread between the rates at which they can borrow and the rates at which they lend. Energy also performed well, as demand has recovered strongly at a time when global supply is constrained. IT and healthcare also outperformed the wider market. However, 'bond proxy' sectors such as utilities, real estate and consumer staples performed poorly as risk-free yields rose. Materials also struggled due to concerns related to the very rapid rise in input costs for energy-intensive industries and fears that energy prices could continue to rise as we approach the winter demand peak.

Fund review

Over the quarter the SVS Sanlam European Equity Fund produced a performance of 2.5% (A Share class – source: Morningstar), thus outperforming the MSCI Europe ex UK index by a significant margin. Outperformance was driven primarily by a combination of favourable allocation and selection effects, with the latter the key driver of performance. In allocation terms, the Fund profited from being overweight IT, which outperformed, and underweight consumer staples, which struggled in Q3. Selection effects were positive in industrials, communication services, financials, healthcare, utilities and consumer discretionary.

Our investment approach is growth oriented, high conviction and typically low turnover. Nonetheless, given the evolving backdrop, we made some changes to the portfolio in Q3. We started a new position in ID Logistics, a leader in contract logistics. The company is benefiting from the rapid growth of e-commerce, which now accounts for c.30% of its activity. We also restarted a position in Orpea, a leader in dependency care that we have followed for many years.

In terms of sales, we exited our position in copper producer and recycler Aurubis; the company's Stolberg site was affected by the severe weather in Germany in July, which has hit production.

Performance data

	Inception	QTR	1yr	3yrs	5yrs
A GBP Income	17/05/90	2.5	23.6	10.3	9.4
MSCI Europe ex UK		0.5	20.9	8.4	9.4

Performance beyond one year is annualised

12 Months to	Sep-21	Sep-20	Sep-19	Sep-18	Sep-17
A GBP Income	-3.7	6.5	1.9	-2.8	20.0
MSCI Europe ex UK	20.9	-0.5	5.8	1.3	21.4

Past performance is not an indicator of future performance.

Source: Sanlam, Morningstar and Lipper as at 30/09/2021.. Figures for periods longer than 12 months are annualized. NAV to NAV figures are used. Net of charges.

*Portfolio yield is calculated by adding the net dividend amounts for all dividend types that have gone 'ex' over the past 12 months based on the dividend frequency.

Key facts

Fund AuM	£26.3m
Number of Holdings	30
Fund Managers	Giles Worthington Chris Ford
Benchmark	MSCI Europe ex UK
Fund Launch Date	17 May 1990
Domicile	UK
Base Currency	Sterling
Fund Type	Unit Trust
IA Sector	Euro ex UK
Morningstar Category	Europe ex-UK
Dealing Deadline	11:59 (GMT)
Settlement Time	T+4
Valuation Point	12:00 (GMT)
Distribution	Annually

Performance attribution

Looking at the stock level data, the Fund benefited from its holdings in VAT Group, ASM International and ING. VAT Group has enjoyed very encouraging rates of growth, with half-year 2021 net sales, EBITDA, EBITDA margin and FCF reaching record levels. ASM International delivered robust Q2 results (reported in late July), with its order intake surging to a new quarterly record of €516m on the back of strong demand. ING reported better-than-expected quarterly profits and said it would restart paying dividends as it reversed some provisions for bad loans that were made due to the Covid-19 pandemic.

Laggards over the quarter included our positions in Worldline, Kering and Aurubis. Worldline missed expectations for HY operating earnings before depreciation and amortisation, causing some weakness in the shares, which had rallied into the results. Luxury stocks such as Kering struggled in mid-August as the Chinese government announced that it would start to target what it called 'wealth inequalities'. This took some of the shine off the company's excellent quarterly results in July, which showed that sales nearly doubled in Q2 as Covid curbs were relaxed in much of the world; for the company's famous Gucci brand, sales soared 86% year on year. As noted above, we exited Aurubis after it was hit by severe flooding in Germany.

ASML and Novo Nordisk, which we don't own but which were strong performers in the index, also featured in the bottom five stock-level attributors.

Outlook

At the start of the year, it had been hoped that Q4 could see Europe returning to some form of normality as vaccine programmes were brought to bear. While the reopening over the summer was very welcome, the recent and unexpected surge in energy prices was not, and has served to highlight once again that Europe, particularly Germany, is highly reliant on imported energy.

Looking forward, concerns of stagflation in Europe are overdone in our view, but soaring energy prices and rising bond yields have led to strong returns form some of the 'value' oriented segments of the market. Rising input prices are obviously a worry if they continue unabated, but they tend to be a bigger problem when top-line growth is modest and corporate pricing power is low or non-existent – clearly that is not the case at the moment as there is still a lot of pent-up demand. Nonetheless, we'll be watching developments carefully for any signs that corporate pricing power is weakening.

Optically, European equity valuations appear cheap versus those of the US, although we'd argue the discount is warranted given the weight of European banks in the index, where long-term growth prospects remain sclerotic at best, albeit that rising bond yields have given the sector a boost in recent weeks.

Within the Fund we will seek to find the optimal mix of genuine global leaders that just happen to be domiciled in Europe, regional champions, and attractively valued thematic beneficiaries.

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Important Information

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The value of this portfolio is subject to fluctuation and. **past performance is not necessarily a guide to future performance.** The performance is calculated for the portfolio and the actual individual investor performance will differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. All terms exclude costs. Fluctuations or movements in exchange rates may cause the value of underlying investments to go up or down. Do remember that the value of participatory interests or the investment and the income generated from them may go down as well as up and is not guaranteed, therefore, you may not get back the amount originally invested and potentially risk total loss of capital. Therefore, the Manager does not provide any guarantee either with respect to the capital or the return of a portfolio. The Manager has the right to close any Portfolios to new investors to manage them more efficiently in accordance with their mandates. Collective Investment Schemes are traded at ruling prices and can engage in borrowing and scrip lending. Collective Investment Schemes (CIS) are generally medium to long term investments. A schedule of fees and charges and maximum commissions is available on request free of charge from the Authorised Corporate Director, the Investment Manager or at www.sanlam.co.uk. **This document is marketing material and is not intended as a recommendation to invest in any particular asset class, security or strategy**.

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Smith & Williamson Fund Administration Limited is the Authorised Corporate Director of the Smith & Williamson Unit Trusts.

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