CCLA
GOOD INVESTMENT

CCLA Better World Global Equity Fund

Commentary – Q2 2024

Having made a strong start to 2024 – which saw total returns from the global equity market (as measured by the MSCI World Index) of 9.88% in sterling terms over the first quarter of the year – equities had a more muted period in the second calendar quarter. Total returns from the global equity market as a whole were 2.56% in sterling terms over the three months of April to June.

Many major economies have demonstrated economic growth during the first half of 2024 – notably the US where real GDP* increased at an annual rate of 1.4% in the first quarter and 2.8% in the second quarter of the year.**

We expect this economic growth should bode well for corporate earnings and hence for equity returns, although Markets will continue to be alert to emerging macroeconomic data, such as inflation, and commentary from central banks, responding to reflect any implications that new information may have for the path of monetary policy (e.g. changes in interest rates).

While we continue to see an improvement in the performance of areas such as banks and energy companies, much of the market returns continue to be driven by the largest US technology businesses (Nvidia, in particular). In fact, the top five contributors to performance of the S&P 500 this year (Nvidia, Alphabet, Microsoft, Meta, Amazon) account for 57% of the returns of the index and accounted for more than half of the index's +26% return last year. In Q2, this concentration of returns was even greater, with Nvidia, Microsoft, Apple & Alphabet alone accounting for over 100% of the index return (i.e., without these the value of the index would have fallen).

Looking at sector-specific returns, only Information Technology and Communication Services outperformed the wider MSCI World Index through the second quarter, whilst most other sectors were broadly flat.

This divergence in performance comes amid still, we consider, reasonable expectations for earnings growth in many other areas of the market, as indicated by recent earnings expectations given by companies.

Fund performance

Performance of the CCLA Better World Global Equity Fund (fund) lagged the MSCI World Index (the fund's comparator benchmark) over Q2, returning 0.03% compared to the comparator benchmark return of 2.56%. This takes the one-year return of the fund to 16.74%, trailing the comparator benchmark which has returned 20.88%.

While a positive contributor to returns, **Nvidia** was the single largest headwind to the fund's relative performance (when compared to the comparator benchmark). The stock has risen over 150% year to date, accounting for nearly 25% of the MSCI World Index return, and a 2% headwind to relative performance. In addition, other stocks in the Magnificent 7*** remain a headwind. While we own Microsoft, Amazon and Alphabet, to ensure diversification within our portfolios these positions are smaller than found in the MSCI World Index and therefore when they perform well the fund's performance relative to the comparator benchmark will not be as good.

Elsewhere in information technology, while we have seen strong performance from other companies in the semiconductor industry with **TSMC**, **Broadcom** and **ASML**, weakness across the software companies we hold, has held back our returns. In Q2 we did start to see an improvement in performance in some of these positions, such as **Adobe** and **ServiceNow**, following a promising set of results, however the software industry continues to materially lag semiconductors as the AI capital expenditure (capex) cycle dominates the sector. Capex is money that is used by a company to acquire, upgrade and maintain their assets.

The other meaningful area of weakness against the comparator benchmark is within financials. The driving factor behind this has been a sharp rotation towards banks and away from areas that our strategy is focused on such as market infrastructure, data/analytics businesses and payments. The banking sector has performed well on the back of a market consensus forming around a favourable macro-outlook and 'higher for longer' interest rates that will likely support net interest income. However, two of our holdings, Asian financial holdings **AIA** and Indian bank **HDFC**, rallied in the period.

Performance within the healthcare sector has also been a factor behind the weak relative returns this year. Our exposure to life science tools businesses such as **Agilent**, **Thermofisher** and **Avantor** has been a headwind, as expectations of a recovery in demand following the destocking cycle last year remains elusive. In addition, as healthcare costs continue to rise as the industry normalises post the pandemic, costs for managed care providers such as **Humana** have led to weak performance in that industry. The sector returns have been led by **Novo Nordisk**, which we hold primarily due to the diabetes care medications and devices it manufactures.

Performance within industrials has continued to be robust due to on-going strength in capital goods and professional services, with **Trane Technologies**, **Schneider Electric**, **Relx** and **Experian** continuing to perform well.

Performance within communication services was strong, fuelled by strong returns from **Alphabet** and our absence from several weaker performing areas of the market such as telecoms.

Consumer discretionary and consumer staples remain challenging as investors continue to shun traditional defensives, such as the household goods and food beverage businesses – at the same time as concerns over the health of the consumer persist.

Fund activity

During the quarter, we initiated a new position in **Ashtead Group**, a leading equipment rental company with national networks in the US, UK, and Canada and with multiple structural growth drivers. The company provides a wide range of construction and industrial rental equipment from large machinery to handheld tools. Ashtead is the #2 equipment rental company in the US and also holds #1 and #2 positions in the UK and Canada. The company is a high-quality operator with a proven expansion strategy and a healthy balance of organic and inorganic growth. We expect Ashtead will continue to leverage its scale, breadth, and technology advantages over smaller undercapitalised rivals to drive market share gains and consolidate a fragmented industry.

Another purchase was **Compass Group**, a best-in-class caterer and market leader benefiting from clear structural growth driven by ongoing first-time outsourcing and industry consolidation within a fragmented market. The food service sector is a game of scale, Compass Group (as the largest) is best positioned to capitalise on those scale advantages, where larger players can leverage their size to achieve more effective purchasing, optimise fixed costs, and provide products and services to clients. This can create a virtuous circle of growth and competitive advantage. We believe, Compass Group offers structural growth and attractive steady compounding attributes with low volatility.

We exited our position in **Blackstone Group** which is a company we held for several years, during which the business has grown considerably and has shifted away from private equity and significantly towards real estate. Whilst we do not believe there is anything inherently wrong with the Blackstone business and we expect it will continue to benefit from increased allocations to private markets over time, the sheer size of the business means that growth going forward will likely be lower than it has been historically, whilst competition from smaller players who are getting larger and growing faster will only likely intensify.

We also sold our holding in **Prudential**, which is one of the two life insurance companies (alongside AIA) which have been the main beneficiaries of growth in emerging market life insurance. As GDP per capita rises in these countries, consumers begin to buy life insurance, albeit with current penetration levels being very low. Prudential and AIA are leaders in the market with significant scale advantage, but we have greater conviction over the long term in AIA than in Prudential. We perceive the management of AIA to be more in tune with the local market dynamics than that of Prudential. Additionally, AIA fully owns its Chinese operations, whilst Prudential only owns 50% via a Joint Venture structure.

Positioning and outlook

Much has been made by market commentators regarding the contribution of the so called Magnificent 7 to overall growth in earnings. Given the size of these businesses and the potential level of growth, there is no doubt that they have made a big contribution. However, this is only half of the story. Over the last year, several areas within the market have been in a downcycle, notably commodities, but also pharmaceuticals and healthcare equipment manufacturers as they suffer the hangover following significant growth during the covid pandemic. However, we believe this masks a plethora of opportunities for growth for those investors willing to look beyond big tech and seek exposure to the wide range of secular growth opportunities available. For example, in the healthcare sector, ageing demographics and subsequent investment into research and development for new therapies will benefit those in the supply chain. We expect, companies such as **Thermofisher** and **Danaher** will likely be key beneficiaries. In medical devices, companies such as **Stryker** are rolling out innovative products in areas such as robotic surgery. Meanwhile, within the industrials sector, the drive for greater energy efficiency will benefit those companies whose products enable companies and asset owners to reduce their carbon footprint. These could include companies like **Schneider Electric** and **Trane Technologies**. Likewise, there remains a great opportunity for companies that provide data and analytics products to various industries, such as finance and legal, demonstrated by the attractive growth at businesses such as **Relx**, **Experian** and **S&P Global**.

Therefore, whilst AI is clearly an exciting opportunity and a number of companies in the Magnificent 7 continue to provide the opportunity for future growth, they are clearly not the only mechanisms by which investors can gain exposure to compound growth in earnings and cash flows. Indeed, the long-term beneficiaries of investment in AI may well prove to be the thousands of companies outside the technology ecosystem who can use AI to improve their efficiency, develop new products and create new consumer experiences.

The CCLA Better World Global Equity Fund is focused on investing in, what we consider are, high-quality companies that can grow and compound cash flows at returns on invested capital that are consistently above their cost of capital (the expense incurred by a company to fund its operations). Stocks with these characteristics tend to have the ability to grow and compound their cash flows, which should, we believe, allow them to drive better returns over the long term.

We continue to avoid and remain cautious on areas of the market that we see as low return, highly cyclical and structurally challenged. For instance, we have very little exposure to banks; we believe rates have peaked, net interest margins are under pressure and credit conditions are tightening. We're also very selective in consumer exposure, preferring companies with strong brands such as **L'Oreal**.

We will continue to look for a wide range of growth opportunities, keeping our focus on quality and reasonable valuations whilst ensuring the fund is well diversified.

*Real GDP is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy (of a country or a place) in a given time period.

Source: MSCI, Bloomberg and HSBC as at 30 June 2024. Fund performance source: HSBC. Comparator benchmark: MSCI World Index.

Sector and individual stock returns are sourced from Bloomberg.

**Source: US Bureau of Economic Analysis.

***Magnificent 7 stocks: Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta Platforms and Tesla.

Important information