CCLA
GOOD INVESTMENT

Better World Global Equity Fund

Portfolio Manager Commentary – Q3 2024

Commentary

Global stock markets rose 0.23%[1] over the quarter.

The third quarter had its rocky moments: following the Bank of Japan raising interest rates investors retreated from the 'yen-dollar carry trade'[2], the rally in some tech shares stalled when their profit outlooks weakened in July, and weaker US economic data briefly raised fears for a recession. But a broad rally boosted markets for most of the quarter, buoyed by earnings reports, reassuring inflation readings and interest rate cuts by many central banks.

Q3 sector returns were led by Utilities, partly due to interest rate falls and partly on the hope that power-hungry artificial intelligence will drive a surge in electricity demand and transform growth expectations for the sector. Materials and Industrials also performed strongly through the quarter, while Energy and Information Technology (IT) lagged.

Fund performance and positioning.

Despite performance of the fund lagging its comparator benchmark, the MSCI World Index, (the Index), over Q3, returning -0.84% compared to the Index return of 0.24%, we are confident in the positioning of the fund as we believe there are reasonable expectations for earnings growth in many areas which we favour.

During Q3, companies in the Financials sector performed well, with returns led by **AIA Group** following the improving sentiment on China, the region which has been the main headwind this year. Other financials sector holdings; **Partners Group**, **London Stock Exchange**, **S&P Global** and **Tradeweb**, also performed well.

Industrials was another strong area for the fund with **TransUnion**, **Ashtead** and **Trane Technologies** all performing well. However, we also saw the value of some US based businesses fall, such as **Ametek**, following weaker than expected earnings results, reflecting a slower environment for general industrials.

Our absence from Energy was a significant benefit to performance relative to the Index, for the quarter, as falling global energy prices led the sector down nearly 8%.

Communication Services was the biggest detractor to relative fund performance. **Alphabet** had a difficult quarter, falling as investors began to turn away from US big tech[3] and as anti-trust[4] concerns grew.

Returns in IT were also weak, with Semiconductor businesses the worst performing sector over the quarter. **Nvidia** saw a fall it its share price after strong results failed to exceed lofty hopes, whilst **ASML** fell on concerns over lower demand from

China and Intel. Whilst hurting performance on an absolute basis, our underweight position to this sector helped relative returns.

Healthcare performance was relatively mixed. **Illumina** and **Avantor** performed well, however weakness in some of the health care equipment businesses such as **Edwards Life Sciences** and **Humana** more than offset this.

The fund remains focused on investing in what we believe 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). Whilst companies with these characteristics tend to trade on a premium to the market on current earnings multiples, their ability to grow and compound their cash flows should, we believe, allow them to drive better returns over the long term.

We like Technology, and the long term trends within it. However we prefer to hold a number of companies, rather than concentrating our exposure to one or two companies.

Whilst Artificial Intelligence (AI) is clearly an exciting opportunity and a number of companies in the Magnificent 7[5] continue to provide the opportunity for future growth, they are clearly not the only companies 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.

Although being a drag on performance over the last 12-18 months, Healthcare and Life Science Tools companies have seen markets and earnings turning positive. Forecasts suggest that more normal ordering patterns are starting to resume and we expect that these sectors will return to generating mid-high single digit growth rates.

Growing demand for Luxury Goods has been evident across key global markets, however, luxury goods businesses are not all made equal. **Hermes** and **LVMH** will, in our view, exhibit more quality and defensive characteristics than the likes of Gucci, for example and we think these companies are increasingly attractive on a longer term basis.

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 interest rates have peaked, net interest margins are under pressure and credit conditions are tightening with the potential for higher provisions for, for example, bad debts. We're also very selective in consumer exposure, preferring brands such as **L'Oreal** over retailers.

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.

Fund activity

Most fund activity during the third quarter focused on taking profits from some of the best-performing companies, to reinvest in those that we considered better placed to add value going forward. We sold the fund's positions in medical technology firm **Edwards Lifesciences**, coffee chain **Starbucks** and discount retailer **Costco**. Instead, we added positions in energy equipment manufacturer **Spirax Group**, insurance broker **AJ Gallagher** and French luxury brand **Hermès**.

Spirax Group is a global manufacturer of industrial energy management systems and flow control equipment such as valves. Spirax has over 110,000 direct customers across 130 countries, with a direct sales presence in 66 countries. The company has 2,100 direct sales and services

engineers and 10,000 employees. The company is notable for its defensive (i.e. stable throughout both economic upturns and downturns) revenue profile, with 85% of sales from maintenance and operating budgets and 40% “self-generated” sales.

AJ Gallagher, is a leading mid-market insurance broking business that is gaining market share through organic growth and acquisitions that we believe should continue for many more years, given the fragmented nature of its industry. Profitability is high and margins should improve as the business continues to gain scale, leverage its data platform and expand its centres of excellence in India. Organic growth is set to slow from high single digits in recent years to mid-single digits, as growth slows and insurance pricing falls.

Hermès, the French luxury brand with a strong heritage in leather goods manufacturing has 300 exclusive stores, of which 222 are directly operated, with 20,000 employees worldwide. The company operates seven divisions: leather goods and saddlery (43% of sales), ready-to-wear (27%), accessories, silk and textiles, perfumes, watches, and other. We expect Hermès to return more cash to shareholders over the short to medium term, by way of special dividends[6].

Edwards Lifesciences, is a medical technology company specialising in artificial heart valves and blood flow monitoring. We exited this position after a profit warning and concerns over growth within some segments of the company. For the company’s revenue growth to be realised as forecast (from US$300 million in 2024 to US$2 billion by 2030), Edwards needs significant success across several clinical trials, which are not a given.

Starbucks was also sold - the coffee chain’s latest quarterly results were among its weakest ever, with traffic down 7% and membership down 4%. Challenges included boycotts, premium products amid weaker consumer sentiment, operational bottlenecks and adverse weather. In addition, China, which makes up 40% of Starbucks' store growth, is facing economic pressures and more competition. These complex challenges don’t have straightforward solutions, so we sold our position in favour of businesses we believe have clearer paths to growth.

Retail chain, **Costco’s** share price had performed well recently and its valuation had increased significantly since we first bought it. This led us to exit the position on valuation grounds. However, Costco remains on our watchlist and we may look to buy it again, should it become more attractively valued.

Source: Fund performance source: HSBC as at 30/9/24. Comparator benchmark: MSCI World Index.

[1] Bloomberg as at 30/09/24, measured by the MSCI World Net GBP Index.

[2] A currency carry trade is where traders borrow in a low interest rate currency and invest the proceeds in a high interest rate currency.

[3] Major, multinational US technology companies. Typically, Alphabet, Amazon, Apple, Meta and Microsoft.

[4] Anti-trust refers to laws that protect trade and commerce from unlawful restraints and monopolies or unfair business practices.

[5] Magnificent 7 stocks: Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta Platforms and Tesla.

[6] A special dividend is a non-recurring, one-time dividend distributed by a company to its shareholders.

Important information

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