Global Thematics strategy

Concerns over inflation and the prospect of higher interest rates led to significant volatility

- 'Value' outpaced 'growth' on strong performance from banks and energy companies
- All themes declined but payments names were a bright spot in 'Connected Consumer'
- We selectively reduced some high duration positions in favour of quality companies

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What's happening?

Global equity markets declined in January as concerns over inflation, higher interest rates and geopolitical tension in Eastern Europe led to a sharp increase in volatility. Value notably outperformed growth during the month as higher treasury yields and rising energy prices led to strong outperformance from banks and energy companies. Conversely, high growth companies derated as investors reassessed the value of future earnings in the context of higher interest rates going forward.

In the US, retail sales declined in December due to the impact of Omicron but other economic indicators held up well. The consumer price index increased 7% year-on-year and producer prices continued to climb in the face of sustained supply chain disruptions, rising materials costs and a tight labour market. In response, Fed Chair Jerome Powell suggested that a first rate rise is likely in March and refused to rule out a more aggressive sequence of increases thereafter.

Economic activity in Europe was resilient and low COVID hospitalisation rates encouraged several countries to lift restrictions. UK equities notably outperformed owing to its large weighting in financials and commodity stocks. The European Central Bank indicated that rates are unlikely to rise in 2022 despite rising inflation, which reached 5% year-on-year in December, while the Bank of England is expected to raise rates five times this year.

In China, the domestic economy showed further weakness with decelerating fixed asset investment and subdued retail sales; however, export numbers continue to be strong, rising 20.9% year-on-year in December.

Portfolio positioning and performance

The strategy underperformed the broader equity index (MSCI All Country World) in January as growth stocks remained under pressure during the month. All themes posted negative returns while 'Cleantech' and 'Automation' declined the most.

In 'Cleantech', shares in renewable energy solutions company Ameresco fell sharply. Investors reacted negatively to the postponement of its analyst day, which the company put down to covid concerns, while supply chain issues are expected to delay its solar projects. Despite this, we remain confident in the company's prospects given a diversified pipeline across energy infrastructure and renewable asset development.

Our position in semiconductor testing company Teradyne weighed most on 'Automation' after management provided weaker than expected guidance citing supply constraints and a drop in demand from one of its customers. While sales are likely to weaken over the coming quarters in response to key customer investment cycles, strong demand for chip testing, driven by increasing chip complexity, remains a notable tailwind for the company over the longer term.

'Ageing & Lifestyle' declined led by our position in Dexcom, which offers continuous glucose monitoring systems for diabetes management. The stock pulled back alongside other high growth names without any fundamental change in outlook. We expect the company to continue to deliver strong earnings growth supported by the launch of its latest G7 system in 2022 and opportunities in Type 2 diabetes further down the line.

On the positive side, 'Connected Consumer' returns were boosted by further gains from payments companies FIS, Global Payments and Visa. The group underperformed in 2021 but we expect their resilient earnings to prove more attractive in the context of slower growth more broadly in 2022 while further economic reopening and higher cross boarding payments should provide further upside.

We selectively reduced some high growth positions in favour of quality companies with lower duration risk which are well positioned to benefit from further reopening of the global economy. Examples include credit card issuer American Express and consumer goods company Unilever, while we also initiated a position in orthodontic technology company Align Technology which sold off with other growth names and provided an attractive buying opportunity.

Outlook

The recent market volatility is likely to persist as major central banks around the world embark upon an extended period of interest rate rises and quantitative tightening. The number of rate hikes expected in the US has markedly increased over recent months but we hasten to add it will take some time before we get back to pre-pandemic levels. Furthermore, economic activity remains robust and continued easing of covid related restrictions is supportive. While we expect growth to moderate in 2022, the trends underpinning the Evolving Economy continue to strengthen.

Solid industrial activity and strong order books for industrial robotics companies highlight the positive outlook for 'Automation' while ongoing supply chain disruptions only strengthen the case for automated solutions. 'Connected Consumer' companies have benefitted from an acceleration in the adoption of digital technologies since the pandemic and we expect this to continue as the economy forges ahead with its digital transformation. Further commitments from nations globally to dramatically lower emissions, combined with the recent volatility in energy prices, underlines the need for clean energy, storage and energy efficiency solutions which provides a strong tailwind for 'Cleantech' companies.

From a demographic standpoint, the ageing global population continues to create opportunities for 'Ageing & Lifestyle' companies which are positioned to benefit from long term changes in consumption patterns. The regulatory clampdown has weighed on sentiment in China but trends which include increasing wealth and financial inclusion, urbanisation and access to healthcare provide a positive backdrop for 'Transitioning Societies' more broadly.

We retain the view that high quality management teams, operating businesses with a sustainable competitive advantage in their markets and with the benefit of secular tailwinds are well placed to navigate the evolving economy. The strategy is therefore well positioned to benefit from the secular shifts we are witnessing globally.

No assurance can be given that the Global Thematics Strategy will be successful. Investors can lose some or all of their capital invested. The Global Thematics strategy is subject to risks including Equity; Emerging markets; Currency; Global investments; Investments in small and/or micro capitalisation universe; ESG.