Evenlode Global Investment View

March 2022

Market data is from Factset and FE Analytics.

The war in Ukraine continues to dominate the news agenda and has driven volatility in commodity and equity markets. Large intraday price swings have become routine as traders digest the latest developments in the conflict, the impact of sanctions in Russia, and the effects of reduced supply of energy, industrial and soft commodities.

Equity markets had started the year on a downward trajectory following strong returns through 2021. Whilst the Russian invasion of Ukraine initially caused further declines, the global market now sits above its pre-war level as measured by the MSCI World Index, albeit down by -6% so far this year in sterling[i]. This headline masks a wide dispersion in returns by stock and sector. With the price of oil rising the energy sector has soared, being up 26% in 2022[ii]. Bringing up the rear in terms of sector performance are information technology companies, down -12%.

The fund is a little behind the index in 2022 to date, down -8%. In addition to having no energy companies within the portfolio, the lack of financials has also been a drag on relative performance as the prospect for rising interest rates in response to inflation has improved the outlook for banks and insurance companies. These two unowned sectors account for most of the underperformance in isolation, but within the portfolio there have been differing market fortunes.

Inflation and potential interest rate increases have had an effect beyond the financials. Companies that produce physical goods have seen cost increases and share price underperformance. The fund has higher exposure to consumer staples, creating a drag against the benchmark, and lower exposure to consumer durables, creating an offsetting effect. Service providers are less exposed to inflation but have seen varied performance. Media and Communication companies, like Omnicom, Publicis and Wiley, have fared well. The information technology sector has been weak, though companies that already generate significant cash flow have outperformed. With our process preferring such companies, this explains the outperformance of the fund's technology exposure when compared with the benchmark. The divergent market paths of some companies have led to some interesting valuation opportunities presenting themselves. Before looking at two new holdings for the fund, we'll complete the picture that we started to paint last month[iii] from corporate reporting season.

Rounding off results

Away from the market action companies continue to report on their real-world operations and over three quarters of the portfolio have now provided a quarterly or annual update on their results. Since last month those that have provided us with new information have been continued the trends we'd previously seen. The portfolio saw revenues grow by 12% on average in 2021[iv], slowing to 8% in the final quarter[v] of the year. Operating profit grew ahead of this, and free cash flow grew in the mid-single digits, lagging profitability as expanding operations used up some cash in working capital and due to some special cases such as transportation brokerage C H Robinson Worldwide helping clients to cope with severe market volatility.

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GICS Sector	2021 Operating Results		Portfolio Total Returns		
	Average Revenue Growth	Average Operating Profit Growth	2022 to date	2021	Total period
Communication Services	11%	37%	3%	26%	30%
Consumer Discretionary	23%	56%	-14%	40%	21%
Consumer Staples	7%	-1%	-9%	5%	-5%
Health Care	9%	6%	-4%	24%	19%
Industrials	15%	30%	-7%	32%	23%
Information Technology	9%	22%	-10%	44%	29%

Source: Corporate reports, Factset, Evenlode Investment. 2022 returns to 16/03/2022.

The table [above] shows how results for the underlying portfolio companies panned out by sector, and the breakdown of investment returns for the prior year and current year to date. The positive outturn for communications companies in the market is matched by the operating performance of the sector as it recovered from the covid-related downturn in 2020. 'Industrials' comprises mainly business services companies for the portfolio, showing solid corporate performance and returns. The well-discussed decline of the information technology sector this year came on the back of very strong performance last year, and the overall decent total returns have been backed by solid operating results. The health care sector had a solid-not-spectacular operating result, as we would generally expect, but that did not stop it posting decent market returns.

Bringing up the rear is the consumer goods sector, lagging in total returns and with a moderate decline in profitability compared with growth experienced in other sectors. We discussed some of the margin dynamics at play in last month's view, so won't repeat them here except to note that the reported figures bear out the negative effect of input costs but with early signs of price increases being passed through. With these two factors somewhat offsetting each other so far, the figures show that profitability has been more-or-less maintained in the sector. The stability of profits and cash flow is something that we like about the sector 'before the event'. Cash flows have declined; Nestle for example chose to spend money on inventories to act as a buffer to the supply chain disruptions they were experiencing. But they have not been so severely impacted that these businesses have challenges funding their operations, and it is very important that these, and all, companies continue to invest in their futures.

New holdings

Two companies new to the portfolio have been purchased over the course of the last six weeks, financial data and services firm Broadridge, and sportswear giant Adidas. Both of these businesses were already in our investable universe of companies that tick all of our investment boxes. Share price declines meant that we brought them into the portfolio.

Broadridge provides various services that help to stitch information flows together in capital markets. Its largest division, enticingly entitled Investor Communications Solutions, looks after the dull-but-important business of ensuring that communications from companies and funds reach their investors. These communications include the 'proxy statements' that enable shareholders to vote at company meetings. While this sounds simple, the process is complicated in the US as many shareholders do not share their details directly with the company they hold an ownership stake in or with the exchange. Instead Broadridge compiles unique and irreplaceable directories of shareholders and is absolutely dominant in the US. It also has international operations and can layer additional services on top of its core operations such as middle office systems for wealth managers. It has a dividend yield of 1.5%, and whilst free cash flow is subdued at the moment due to rolling out new systems, a longer-term view shows very good cash generating ability.

Adidas probably needs no introduction. It is second to Nike in the global sportswear market, but the two companies are the giants of the sector with clear daylight to others like Puma (founded by Adidas founder Adolf Dassler's brother, Rudolf) and upstart Under Armour. The brand is at the crux of the investment case, and Adidas' scale means that it can invest in the biggest sponsorships to reinforce the image of its products. The company has been experiencing supply disruption, notably in Vietnam where its contract manufacturers of footwear are predominantly based and were affected by coronavirus lockdowns. This weighed on the share price in 2021, and more recently exposure to Russia has not helped, with around 2% of sales from the region. The company has shut all stores in and supply of products to Russia, which will be a drag on revenues and profitability. However, growth drivers globally remain, especially in the US and China.

Volatility remains

The swings in commodity prices following the invasion of Ukraine have been at times wild and in some cases like Nickel have caused the ceasing of trading altogether. It is a reminder, if we needed one, that fragilities exist in the global system of supply following the effects of the coronavirus pandemic. All businesses are being affected, and it seems likely that there will be further supply chain challenges to overcome during 2022. We continue to focus on ensuring the companies in the portfolio are resilient to a wide range of economic scenarios.

We have surveyed the companies in the Evenlode portfolios, asking them about direct exposure to Russia and Ukraine, operations in the region, and their supply chains. The revenue exposure for all portfolios comes in at under 1% of sales, and manufacturing and supply are highly localised where they do exist in the region. Companies from LVMH to WPP are doing their best to protect staff and we commend them on their efforts. Whilst the current effects on portfolio companies' operations are small relative to the scale of their global operations, the conflict is vividly demonstrating the human cost of violence. Our thoughts are with those that have lost loved ones and been displaced by the conflict, and we continue to hope for a peaceful resolution in Eastern Europe.

Ben, Chris, Bethan, Rob and the Evenlode team
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For full information on fund risks and costs and charges, please refer to the Key Investor Information Documents, Annual & Interim Reports and the Prospectus, which are available on the Evenlode Investment Management website (https://evenlodeinvestment.com). Recent performance information is also shown on factsheets, also available on the website.

Past performance is not a guide to future returns. The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Fund performance figures are shown inclusive of reinvested income and net of the ongoing charges and portfolio transaction costs unless otherwise stated. The figures do not reflect any entry charge paid by individual investors.

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[i] Source: FE Analytics, 31/12/2021-16/03/2022
[ii] Source: Factset 31/12/2021-16/03/2022
[iii] https://evenlodeinvestment.com/news/evenlode-global-income-investment-view-february-2022
[iv] Source: Corporate reports. Mean organic revenue growth for 64% of the portfolio by number of holdings
[v] Mean organic revenue growth for 78% of the portfolio by number of holdings