Santander Asset Management

Marketing Communication

Santander GO Global Equity ESG

10 / 2023

Fund commentary

Market developments:

With another escalating geopolitical flashpoint in the form of the Israel/Hamas conflict, left tail risks came to the fore, resulting in a tough month for global equity markets in October (-3% in EUR; -3% in USD). Navigating the interplay of reporting season against a more nervous macro backdrop, rising yields and markets still trading rich, led to high volatility. As investors digest the first set of profit warnings, mainly in the industrials and consumer discretionary sectors, most companies guide for a sharp deceleration in demand as we exit 2023. Any negative surprise is punished aggressively, it seems, with the market clearly avoiding highly leveraged companies with floating debt and refinancing risks as yields continue to climb. A case in point are, for example, utility companies, often seen as defensive safe havens, yet see much of their 'contracted' cash flows at risk and renewables projects moving out-of-the-money in this rate environment. After the October rout, it seems the market is again torn between geopolitical de-escalation and more dovish central banks, on the one hand, and rising tensions and continuous upward pressure on yields, on the other. Although we recognize several Quality hiding areas are becoming crowded, such as within the technology and healthcare sectors, we continue to prefer stronger balance sheet and free cash flow generation companies over anything else.

Largest holdings:

Alphabet is the largest active position in the portfolio, with the shares still reasonably valued. With leading positions in Search, Cloud and the investments into its AI platform, we believe Alphabet has a long runway for growth with attractive returns. Publishing and data analytics firm RELX is our second largest active position, where we believe that the company can be an important beneficiary of AI as the demand for accurate and trustworthy data only increases, something underestimated by the market. Moreover, its high quality portfolio of scientific journals will minimize the risk of university customers to easily switch off, evidenced by the recent signing of attractive long-term deals. Visa completes our top-3 active positions, as we believe it continues to benefit from the secular shift away from cash as well as from the rebound in cross-border transactions. We also still like the name as we do not think that there will be significant impact from the renewed discussion on interchange fees.

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Performance:

In the month of October, the portfolio had a strong relative performance, despite a negative absolute return. From a sector perspective, our positioning in Consumer Discretionary, Technology and Healthcare paid off most, while Consumer Staples detracted. On a stock-level, we saw managed care provider UnitedHealth Group contributing most, helped by a stabilization in medical loss ratios, together with an upbeat set of results and insurance overall holding up better in a higher-for-longer rate environment. Where several Tech high-fliers struggled to satisfy high expectations, Microsoft certainly did not. Helped by Azure, Generative AI and successful price hikes, the company delivered another strong set of results of accelerating topline growth and expanding margins. On the Industrials side, data analytics company RELX continued its ascent after its publishing arm signed a deal with a German academics consortium, after a long protracted negotiation. This was certainly positive for sentiment on the stock, most likely also drawing a line under investor's concerns regarding the profit model in this division. Furthermore, Eli Lilly once again proved to be a favorite defensive hiding place, lifting the stock higher even without any meaningful company news.

On the flipside, we did see further weakness in the life sciences tool space with Thermo Fisher and industry peers still suffering from a post-Covid hangover, which continues to act as a growth hump they have to cross to restore confidence. Another detractor during the month was Schneider Electric, struggling on the back of broader industrial worries on slowing order trends, weaker pricing and lower PMIs. We do believe the company's businesses are relatively insulated from many of these concerns, but we are still cautious given high expectations on the stock.

Portfolio changes:

In October, we exited our position in Bank of America and replaced it with JPMorgan, which we consider to be a higher quality bank and better protected from an otherwise adverse market environment for banks. We also added AbbVie to the portfolio, a US pharma company with a very promising, yet still vastly underappreciated pipeline. The growth potential of its immunology drugs Skyrizi and Rinvoq more than offsets the drop-off from Humira. As we believe most of the catalysts on the GLP-1 names have played out, interest in other pockets of Pharma will likely increase as we enter 2024. Furthermore, we trimmed positions in names where industry fundamentals have weakened (Trane, Schneider, CBRE) or have taken profits after a strong run (Meta Platforms, Eli Lilly) and redeployed that back into several lagging names where recent performance has actually picked up (e.g., Nike, UnitedHealth).

Management expectations:

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With the macro environment remaining precarious, few business models navigate this relatively unscathed. Rising cost of capital simply result in widening spreads between Quality companies and their weaker, more leveraged counterparts. Valuation also provides little support thus far unless lead indicators clearly bottom out and a proper earnings reset for next year has happened. As everyone is looking for a turning point and gauge what the new base level for growth should be, those companies that continue to deliver earnings beats remain our highest conviction positions in portfolio. The recent risk-off mood and messy geopolitics clearly hurt equities and bonds alike, but we don't see the market as broken. It's more a recalibration to a higher-for-longer-rate world and putting a new multiple on growth, which comes with volatility. And although we are macro aware and share most market concerns, our strategy really is bottom-up oriented, and selectively, we actually see more opportunities arising across the Quality spectrum.

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