R&S European Equity Fund
Q4 2023 Commentary

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PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	5.4%	8.2%	15.0%	35.3%	64.6%	117.2%
FTSE World Europe ex UK TR GBP	7.6%	5.9%	15.7%	26.3%	65.3%	122.1%
IA Europe Excluding UK	8.1%	5.7%	14.3%	20.4%	60.2%	109.0%
Sector Quartile	4	1	2	1	2	2

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested.

MARKET REVIEW

Equities and bonds rose in tandem during the final quarter of the year, as market attention turned away from concerns that interest rates would remain higher for longer and towards anticipation that interest rate cuts would occur far earlier than expected. Signs that inflation was rapidly easing were welcomed and hopes that economies would enjoy a soft landing gained traction from economic data continuing to show unexpected strength. While global economies are still forecast to slow in 2024, fears of forthcoming recessions have receded. This enabled developed market central banks to bring their rate-rising agenda to an early halt, with interest rates remaining flat throughout the period, and forward guidance from the Federal Reserve turning noticeably dovish in December, with policymakers signalling that multiple interest rate cuts may occur in 2024. The European Central Bank (ECB) and the Bank of England were more guarded in their outlooks but still hinted that rates may have peaked. While this improved economic outlook boosted market sentiment, geopolitical risks stepped up a notch amid the outbreak of war in Gaza and the continuation of fighting in Ukraine.

PERFORMANCE & ACTIVITY

Against this more benign backdrop, the Fund gained ground over the quarter, although it underperformed its benchmark. Growth stocks led the upturn and, as a value-biased strategy, the Fund was not necessarily exposed to the right side of this trend, particularly its underweight exposure to the high growth-orientated technology sector. Having been one of the strongest contributors throughout much of the year, the Fund's overweight position in financials, and banks in particular, detracted from performance during the final quarter. Optimism that interest rate cuts would be implemented sooner and possibly more aggressively than expected generated concerns that banks' margins might be squeezed. However, the Fund's position was compensated by strength among the Spanish banks, notably Banco Bilbao Vizcaya Argentaria (BBVA), which benefited from its exposure to Latin America. Cyclicals also enjoyed a strong rebound during the quarter, as lower bond yields led to hopes that refinancing costs might not be as painful as feared. Within the portfolio, we are exposed to some cyclical industrial stocks as well as to those in the building and construction industry.

At the stock level, German telco Telefonica Deutschland, which had been in the doldrums amid increased broadband competition, was boosted by plans for a complete takeover by its Spanish parent, whose offer represented a significant premium on its share price. Advertising group Publicis benefited from the improved economic scenario, as did smart meter manufacturer Landis+Gyr. Aside from banks underperforming in the fourth quarter, some of the Fund's other detractors included defensive names that were left behind amid the market's improved risk-appetite; notable underperformers included distribution company PostNL, telcos Nokia, Telefonica and Orange, and banks Bank of Ireland, Commerzbank and UBS.

Over the period, key transactions included an increase in the Fund's real estate exposure, where valuations had been heavily discounted amid the rising interest rate environment but are now reflecting the market's improved economic expectations. Within banks, we shifted some profits from BBVA into our other bank holdings – such as the Bank of Ireland and ABN whose performance has lagged the wider market in recent times and therefore offer more attractive valuations. We also added to the Fund's more cyclical holdings at the start of the quarter, following a sell-off in Q3. These cyclical additions included Landis+Gyr, electrical distributor Rexel and materials company Mersen.

OUTLOOK

The European economy appears to have shaken off the threat of stagnation, and while the economic picture remains weak it continues to exhibit pockets of economic strength – consumer spending remains healthy and the employment market is robust. European banks, in particular, appear to be well positioned versus US counterparts having strengthened their balance sheets significantly in the years following the global financial crisis, while maintaining conservative lending practices. The strength of the region's banks should be a strong support for the wider European economy. Another pillar of strength should come from a revival in inventories. Having quickly rebuilt stocks following the Covid-inspired supply challenges, 2023 witnessed a period of destocking that was reinforced by lower consumer demand in Europe stemming from the cost of living crisis. We expect the squeeze in inventories to ease this year and are not expecting to see any drop in consumer spending thanks to more positive trends in real incomes.

While the economy is still expected to dominate market direction this year, and an election-heavy year means geopolitics may also have an input, we continue to refrain from making any strong macro allocation statements within the portfolio. That said, we have been cautious about the Fund's exposure to the Chinese market amid concern about its ongoing economic fragility. Instead, we retain a stock-focused approach, selecting well-run, quality companies, with strong balance sheets at attractive prices. The gap between value and growth has widened once more, meaning our long-term value orientation puts the Fund in a good position to take advantage of a recovery for value stocks. A slight increase in our cyclical position has added some risk to the portfolio – although we continue to avoid high-growth areas – but this has been balanced by retaining a certain level of defensiveness.

PERFORMANCE DISCRETE	12 Months to 31/12/2019	12 Months to 31/12/2020	12 Months to 31/12/2021	12 Months to 31/12/2022	12 Months to 31/12/2023
Fund Performance (B Class)	14.8%	5.9%	17.5%	0.1%	15.0%
FTSE World Europe ex UK TR GBP	20.4%	8.6%	17.4%	-7.0%	15.7%
IA Europe Excluding UK	20.4%	10.5%	15.6%	-8.9%	14.3%
Sector Quartile	4	3	2	1	2

Past performance is not necessarily a guide to future returns.

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