

New Capital Dynamic European Equity Fund



Quarterly Commentary | As of 30 September 2024

Market overview

The third quarter of 2024 experienced a sustained rally in global equity markets, despite occasional volatility and economic uncertainties. The MSCI World Index and the MSCI All Countries Index showed consistent gains, with 1 year returns of 18.8% by the end of September.

The quarter opened with a change in investor sentiment in July. Soft US Consumer Prices Index inflation numbers led to the anticipation of a Federal Reserve funds rate cut, prompting a move from mega-cap tech stocks to US small-cap stocks. Reflecting a weakening in the US economy, bond markets rallied, with yields on US Treasury bonds falling to the lowest in more than a year.

August witnessed a continuation of the equity rally, but volatility increased due to fears of a looming US recession and changes in Japanese monetary policy. These concerns added to geopolitical tensions and the prospect of monetary easing and contributed to extend the gold price rally.

September brought new all-time highs for global stock markets. The Federal Reserve started easing interest rates, shifting its focus from inflation control to supporting the labour market and economic growth. Chinese authorities announced measures to stimulate their economy, and declining oil prices provided further market support. Throughout the quarter, all major developed market currencies and the yuan renminbi recovered against the US dollar.

The outlook at the end of the quarter is supported by the expectation of a prolonged period of monetary policy easing and moderate bond yields.

European macroeconomic data releases turned down through September. Alongside this indicated stalling in Europe's growth momentum, inflation continues to fall. At its September meeting, the European Central Bank (ECB) announced a further -0.25% reduction in the deposit rate, to accompany the -0.25% cut made in June. The ECB refrained from pre-committing to a particular rate path and kept its data dependent approach. The ECB revised down slightly its forecasts for 2024 GDP growth (from 0.9% at its June meeting to 0.8% in September) and at the same time revised upwards its 2024 forecasts for core inflation (from 2.8% at its June meeting to 2.9% in September). Importantly, however, they kept their inflation forecasts for 2026 unchanged (1.9% headline and 2.0% core), highlighting that broader progress on the disinflation journey is expected to continue.

Q3 2024 is expected to be another quarter of positive economic growth for the Euro area, albeit at a slower pace than in the first half of 2024, with real GDP expected to grow by 0.15% quarter on quarter (following growth of 0.3% in Q1 and Q2 2024). The September flash Purchasing Managers' Index (PMI) for the Euro area moved back into contractionary territory and at a level that was significantly lower than consensus expectations. Euro area composite PMI printed at 48.9 in September, down from 51.0 in August. Within the report we observed that the divergence across Europe continues to widen - composite PMIs for the rest of the Euro area (excluding Germany and France) remain in expansion and declined only slightly to 51.1 from 51.8 in August, while Germany was down significantly in contraction at 47.2 (from 48.5) and France dropped to 47.4 (from 53.1).

European earnings expectations also indicate subdued momentum at present. So far this year, STOXX Europe 600 EPS revisions for 2024 (-4%) and 2025 (-3%) have been negative.

Conversely, household saving rates look more likely to decline going forward (noting very high levels at present) and credit dynamics have clearly improved, with both Eurozone money and credit data seeing notable improvements in recent months - it appears that troughs have formed in both Eurozone private sector loan growth and money supply growth. Nonetheless, the data remains weak by historical standards. Despite the ECB cutting rates in June and September, policy rates remain in restrictive territory and the timing of future cuts remains uncertain - tight financial conditions are still expected to drag on growth over the coming quarters.

Eurozone inflation numbers for September came in broadly in line with expectations, supporting the disinflation narrative. Euro area headline HICP inflation (Harmonized Index of Consumer Prices) decreased to 1.8% year-on-year in September (from 2.2% year-on-year in August), and core edged down to 2.7% year-on-year (from 2.8% year-on-year), in line with consensus expectations. Services inflation is proving sticky, but it was encouraging to see that negotiated wage growth slowed sharply in

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the eurozone in Q2. It is also important to note that headline inflation is now below the ECB's 2% target. Together, with the weakening in the macroeconomic data in September, this potentially signals a faster pace of rate cuts than what was expected by the market a few months' ago – we cannot rule out a rate cut now from the ECB in both October and December, to take the deposit rate down to 3% by year end.

September proved a broadly stable to positive month for global stock markets, with Emerging Market equities leading the gains following the announcement of significant stimulus in China. Yields on 10-year US Treasuries decreased -13bps in September, finishing the month at 3.79%. In Europe 10-year Bund yields decreased -16bps (to finish the month at 2.12%). It is important to note that both the US and German 2 year-on-year yield curves un-inverted during September, having been inverted for close to two years. Historically such developments have not been positive signals for economic health. The MSCI Europe returned -0.4% through September. Value stocks outperformed growth stocks and cyclicals outperformed defensives in September. Large caps underperformed small and mid-cap stocks. The best performing European sectors were materials, real estate and utilities whilst energy and health care were the major laggards.

Fund performance and positioning

The New Capital Dynamic European Equity Fund outperformed its benchmark over the third quarter (MSCI Europe increased +2.4% in Euro terms). The Fund aims to provide exposure to a core, balanced portfolio of quality European stocks across all sectors in the market, which is managed closely against the MSCI Europe equity benchmark.

Stocks that contributed to relative performance in Q3 2024 were:

- DSM-Firmenich (+17%) – materials – consumer chemicals
- Sartorius Stedim (+22%) – health care - biologics
- Iberdrola (+18%) – utilities – networks & renewables

Stocks that detracted from relative performance in Q3 2024 were:

- ASML (-23%) – information technology - semiconductors
- BE Semi (-27%) - information technology - semiconductors
- Novo Nordisk (-22%) – health care - pharmaceuticals

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	New Capital Dynamic European Equity Fund	MSCI Europe Net Return EUR Index	Difference
1 Month	-0.33%	-0.44%	+0.11%
3 Months	+2.70%	+2.35%	+0.35%
6 Months	+2.68%	+3.71%	-1.03%
YTD	+11.76%	+11.62%	+0.14%
1 Year	+19.60%	+18.80%	+0.80%
3 Years	+19.14%	+26.01%	-6.87%
5 Years	+43.29%	+49.65%	-6.36%
Since Inception Annualised	+6.63%	+7.06%	-0.43%
Since Inception (15/09/2015)	+78.72%	+85.30%	-6.58%

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Outlook

With the ECB cutting interest rates and the European economy continuing to grow, we believe this can be the catalyst for good performance from European equities in 2024, noting attractive equity valuations and reasonably subdued sentiment for the region at the present time. We are also watching stimulus developments in China closely, noting that Asia Pacific accounts for a very significant 20% of revenues within the STOXX Europe 600 index. On the flip side, any further stalling in the Eurozone recovery and a corporate earnings outcome which materially undershoots market expectations and / or significant delays to the ECB implementing further rate cuts will act to pressure European equities in 2024.

Whilst Europe is currently displaying signs of a recovery in 2024, monetary conditions remain very restrictive, noting the impact of 400bps of interest rate hikes having fed into the economy in recent years. The inversion (and recent un-inversion) of European yield curves serves as a reminder that recession at some stage is possible. The possibility of a policy misstep by the ECB cannot be overlooked. Looking at the companies in our portfolios, we are seeing increasing evidence that we are at a late stage in the economic / rate cycle in Europe.

Our base case at present is aligned with what the market expects i.e. that the ECB continues to cut rates at a cadence and this will act as a catalyst to build further growth momentum in Europe. With this in mind we are constructively positioned in the European equity market, currently running portfolio betas in excess of 1, having added to our cyclical and small/mid cap holdings in recent months. Such investments typically perform well as interest rate cuts come through, assuming of course that economic growth holds up. In this regard, we have recently added capital to our holdings within technology, industrials, materials, financials and energy, whilst reducing our exposure in consumer staples, health care and utilities. Given where we are in the cycle and the uncertainty regarding the timing and pace of interest rate cuts, both from the ECB and the Fed, our preference remains very much on quality orientated stocks.

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