



European Equity

Market context

European equities outperformed in January, recovering some of their relative weakness over the prior couple of months, with the benchmark Stoxx 600 reaching a record high. Against a backdrop of more stagnant economic data, the European Central Bank cut rates by 25 basis points over the month and intimated more may be on the way. Banks were particularly strong, with the sector delivering a double-digit return. With politics never far from the agenda, investors also turned their focus to potential tariffs coming from the US, and the snap election in Germany scheduled for 23 February.

The UK was also a record breaker, with the FTSE 100 setting a new high as the benchmark posted its best month for two years. There were a number of drivers, with the commodity-heavy nature of the market benefitting from a strong month for Brent crude after the US announced tougher restrictions on Russian oil and colder temperatures in the Northern Hemisphere boosted demand. Investors also looked to move away from tech stocks after new Chinese artificial intelligence chatbot DeepSeek suggested such technology can be delivered more cheaply than US counterparts, while the weaker pound provided a third tailwind to the UK, with about three-quarters of All-Share revenues coming from abroad.

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Performance

The Strategy underperformed the MSCI Europe Index over the month, gross and net of fees*.

Stock selection in IT hurt performance the most, where BE Semiconductor Industries dropped due to weaker-than-expected demand for semiconductor assembly equipment, compounded by broader concerns over excess capacity in the global semiconductor industry. In consumer staples, UK retailer Marks & Spencer underperformed as concerns over a challenging macroeconomic environment overshadowed strong Christmas sales growth in food and clothing divisions. In consumer discretionary, not holding luxury goods maker Richemont dragged on relative performance, offset by our positions in LVMH and Hermès, which were among the top contributors as the broader luxury complex performed well on signs of a sequential acceleration in top-line momentum.

More positively, stock picking in industrials contributed meaningfully to performance, where German defense company Rheinmetall surged on growing expectations that NATO members will look to revise up defense spending targets from the current level of 2% of GDP, in response to the increased threat level in Europe and pressure from the new US administration. Within IT, SAP advanced due to strong cloud revenue growth as enterprises accelerated digital transformation efforts.

*Where performance is gross of fees, returns will be reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.

Not all securities held have been discussed. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Past performance does not predict future returns; losses may be made.

Outlook

In our last outlook we commented on the 'over-easy' policy environment that, towards the end of last year, saw 26 global central banks cutting rates. Fast-forward to today, and bond markets have responded to stronger economic data with steeper yield curves and higher long-end rates. From recently pricing in five Fed cuts, the market has moved to anticipating only one. In our view a further inflationary shock would be needed to push yields decisively higher from here. Our central scenario remains that we have left a regime of secular stagnation and have entered the new normal – a world of higher real rates and ample stock picking opportunities.

We continue to observe that inflation is nearing the ECB's target, real wage growth is positive in both the UK and Europe, and average household and corporate balance sheets are generally in good shape. It is no surprise to us, therefore, that lead indicators of credit such as loan officer surveys and credit impulse data are turning more positive. In addition, weaker currencies – particularly versus the US dollar – offer potential tailwinds for many of the exporters within the portfolio.

Near-term risks and opportunities remain. In particular, we would highlight three important catalyst events (i) any potential end to the conflict in Ukraine following Trump taking office (ii) scope for the fiscal brake in Germany to ease following the upcoming elections (iii) any clarity on Trump's tariffs providing a welcome clearing event. In the current complex environment, your portfolio is balanced for the variety of potential outcomes for the European economy. The core portfolio contains many value stocks trading on sustainable 10%+ all-in distribution yields, but also retains exposure to multi-year secular growth in areas like semiconductor equipment critical to the advancement of Moore's Law, as well as companies benefiting from the secular growth coming from electrification. We continue to find ample individual stocks across a range of sectors that fulfil our investment philosophy, namely being of good quality with undervalued long-term prospects and for whom a positive inflection in sentiment could see a meaningful move to the upside. In short, we remain optimistic on the outlook for stock picking at present.

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