Ninety One

Global Special Situations

Market context

Global equities ended the final quarter of 2024 with a sharp December sell-off following the US Federal Reserve's cautious outlook on interest rate cuts for 2025. The central bank projected only two rate cuts for the year, down from the four previously anticipated. This dampened the positivity in the previous month, when Donald Trump's decisive victory drove global equities.

There was significant regional divergence, with US equities rising to another all-time high in November before trailing off in the final month of the year, albeit still finishing the quarter in positive territory. Japanese equities also gained, supported by a weaker yen. However, there were pockets of weakness in markets at risk of proposed US tariffs, including China and Mexico, and Europe's auto sector. France was a notable laggard after the government of Michel Barnier fell following the first successful no-confidence vote since 1962 after his proposed budget failed to pass. By sector, consumer discretionary, communication services and information technology were among the best-performing parts of the MSCI All Country World Index. Materials was notably weak, including some of the large mining stocks, with real estate and utilities also underperforming.

Performance

The Strategy delivered a positive absolute return[1] and underperformed the MSCI ACWI (in GBP, gross and net of fees). At the broad level, not holding the large US technology stocks again weighed on relative returns.

At the stock level, the main detractors from relative returns included the following. Housebuilder Vistry issued a profit warning in October after announcing that costs had been understated on a number of projects, subsequently downgrading profit guidance. Shares in specialist semiconductor firm Qorvo underperformed after the company posted disappointing results. Engineering and energy services company John Wood also detracted, after it commissioned an independent review of some of its contracts, as well as disclosing some weakness in its projects segment. Investment company XP's performance reflected the fact that Brazilian stocks have been very weak of late, due to macro fears surrounding fiscal initiatives, interest rate trajectories and weakness of the Brazilian real. Germany-based auto supplier Schaeffler was impacted partly by concern over how US tariffs may hinder Europe's already out-of-favour auto sector.

The contributors to relative returns included drug distributor McKesson and payroll software provider Paycom, both of which delivered encouraging results during the quarter. Shares in insurer Direct Line performed strongly following a £3.7 billion takeover bid from Aviva, which was agreed by the boards in December. British bank NatWest delivered good results during the quarter, with net interest margins and non-interest income both ahead of expectations; and with capital at the top of management's targeted range, this increases the possibility of additional cash returns to shareholders. American Express outperformed on expectations-beating results,

[1] 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.

despite a softening spending environment.

Portfolio activity

Significant buys

- B3 is the Brazilian stock exchange, clearinghouse and registry for most financial instruments. Like most stock exchanges, it is almost a natural monopoly, and its economics show it. The company is currently trading at 11x PE and growing at high-single digits, in one of the worst macro environments the country has faced in the last twenty years. Much like XP, once stability returns to Brazilian capital markets, and perhaps interest rates begin to fall (though the timing of this is unclear), we think this business could grow well into the double digits. In the meantime, we get 10% back annually on our purchase price as dividends and buybacks.
- Tesco has undergone an extraordinary transformation over the last 10 years. From being bloated, unfocused and too expensive for its customers, it has become (once again, one might say) the shrewdest operator in the UK supermarket sector. At the same time, growth at the discounters is slowing, and Tesco has found additional revenue streams that we think are promising. The stock offers a 7% yield between dividends and buybacks, plus mid-single digit growth, which we think is attractive for a liquid large-cap with defensive characteristics.

Significant sells

- The multiple was never high on Bank of America, but the company has just gone through some of its most profitable years. Uncertainty about how long these benign conditions may last made this a good time to sell.
- Direct Line and TI Fluid Systems were sold after the companies received bids.
- After a strong run over the past couple of years, shares in Heidelberg Materials reached our estimate of fair value.

Outlook

When will US mega caps stop dominating global equity performance? We don't know, but it does feel as if there is a limit to how stretched some of these comparisons can become. US stocks' cyclically adjusted valuation premium to European equities is close to a 40-year high, and the starting point of those valuations does not bode well for future US equity returns, based on historical analysis. Whichever way you cut it, US stocks stand out as expensive.

As and when this valuation divergence becomes less extreme, our Global Value strategies should benefit by virtue of their US underweight position, and even our US stocks could do relatively well in such a scenario, as the smaller to mid-sized US companies which we have more exposure to have not enjoyed anything like the multiple expansion of the large-cap cohort.

At a sector level, we commented in the previous quarterly update that autoparts stocks, which we have a large allocation to in our strategies, are some of the cheapest in the world, and this remains the case. That outlier undervaluation was concurrent with outlier underperformance last year, but the auto sector remains extremely cheap and out-of-favour and we continue to see value there. Plenty of other sectors that we have exposure to are also at the cheaper end of the global equity universe, such as financials, insurance and consumer discretionary.

Finally, the median estimated upside of the stocks held in our Global portfolio sits well above the historical average. This should provide a good starting point for delivering returns to our investors in the years ahead.

We are positioned as follows:

- Sector bias: Overweight industrials and consumer discretionary.
- We continue to find a lot of opportunities in:
    - Travel-exposed sectors and stocks, relating to tourism, aerospace industrials and air travel generally.
    - Auto suppliers exposed to a transition to electric vehicles (EVs) and hybrids.
    - Idiosyncratic stories across many other economic sectors, from cyclical sectors such as financials and materials, to more defensive sectors such as healthcare and staples.
- Country: Overweight UK, Europe; underweight US and Japan.

Specific risks.

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