Candriam Sustainable Equity EMU

Market Overview

The long-anticipated start of the Federal Reserve's rate cutting cycle (by 50bp) finally arrived this September, along with a less hawkish tone from Japanese policymakers and new stimulus in China. All this helped to soothe investor concerns and support a strong rally in stocks into the end of the month.
This said, there are certainly a number of factors that are hampering investor's enthusiasm. Weaker macro data in the US and certainly in Europe, are slightly raising the (still low) probability of recession. Military conflicts in the Middle East and in Ukraine are far from over and weigh on investor's confidence. At the same time, one should not underestimate the uncertainty due to presidential elections in the US and difficult government formation in several European countries.
Regarding inflation in Europe, services price gains remains sticky, but there are hints of improvement. Price expectations from the EU survey also point to the GDP deflator slowing further. With inflation cooling and activity relatively muted, other western central banks also deemed it appropriate to cut rates.

Portfolio Highlights

In September, euro zone equities closed the month higher. Our overall performance was slightly positive relative to the MSCI EMU NR©. The sector allocation impact was positive: our overweight in Consumer Staples, Healthcare and Real Estate and our underweight in Energy had a positive impact, that was slightly reduced by our overweight in IT and underweight in Industrials. The stock selection contribution was neutral: positive in Industrials (Kingspan, Duerr) and IT (no exposure to some semiconductor names) but negative in Real Estate (WDP) and Consumer Discretionary (Technogym, Mercedes).

Our main transactions:

- In Communication Services, we slightly increased Publicis.
- In Consumer Discretionary, we exited the position in Mercedes following its profit warning. We increased our exposure to the luxury segment by increasing Hermès and by starting a new small position in Kering.
- In Consumer Staples, we did some profit taking by fully exiting Unilever. We increased our holding in L'Oréal, given a more positive risk reward.
- In Financials, we started a new position in Adyen, one of the leading payment service providers with best-in-class technology based on a unique single platform.
- In Healthcare we reduced Carl Zeiss.
- In Industrials we exited Alfen, which, does not meet anymore our quality of management criteria. Its balance sheet is also weaker. Despite a challenging sector background for capital goods, we increased our holding in Siemens where expectations have been reset at the right level and valuation is attractive.
- In IT we slightly increased ASML.
- In Materials we increased Air Liquide

Fund Outlook

The environment should be more favourable to our portfolio given the ongoing rate-cutting cycle from central banks, which will put an end to the increase in long-term rates. Indeed, Quality/Growth companies will benefit from better valuation metrics and lower financing conditions. In addition, the supply-chain normalization should support B2B suppliers that suffered from a long destocking phase.

Our actual defensive sector allocation may be revised in the coming weeks, ahead of the US elections. A Trump victory with a clear Congress majority would lead to increased long-term rates (negative for Real Estate, positive for Banks). It would be also negative for some European sectors exposed to tariffs (like Automobiles). A clear Harris victory (min. 50 senators) would negatively weigh on Aerospace & Defence and eventually on some Pharmaceuticals. Equity markets may suffer from her fiscal policy (higher corporate taxes).

Concerning China, the last measures announced are a clear positive for the sentiment ("Chinese Put") but the economic trend will stay depressed for a while.

For 2025, in line with our soft-landing scenario of the global economy, we expect Quality/Growth stocks (and particularly innovative companies) to outperform.