Candriam Sustainable Equity Europe

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, European equities closed the month slightly lower. Our overall performance was in line with the MSCI Europe NR©. The sector allocation impact was negative: our overweight in Real Estate and underweight in Energy had a positive impact, but it was more than compensated by our overweight in Healthcare and IT and underweight in Industrials and Financials. The stock selection contribution was positive, mostly in Healthcare (Carl Zeiss, bioMérieux and underweight in Novo Nordisk), Consumer Staples (Reckitt, Beiersdorf, Kerry) and IT (Dassault Systèmes, Hexagon). The stock picking was negative in Materials (no exposure to mining stocks) and Industrials (Rentokil and Tomra).

Our main transactions:

- In Consumer Discretionary, we did some profit taking in Compass and 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 in Unilever and increased our holding in L'Oréal, given a more positive risk reward.
- In Financials, we started two new positions in Adyen and Admiral. Adyen is one of the leading payment service providers with best-in-class technology based on a unique single platform. Admiral is a non-life insurance company with a very strong management team, it relies on a very efficient organisation and its processes and data analysis allows it to better select clients and give them a fast response.
- In Healthcare we reduced Novo Nordisk.
- In Industrials we exited Alfen and Rentokil, both companies have made several profit warnings in the recent quarters and do not meet anymore our quality of management criteria. Their balance sheets are also weaker. Despite a challenging sector background for capital goods, we started a new small position in Atlas Copco, one of the highest quality names in the industrials sector with a high exposure to China (>20% of its revenues).
- In IT we slightly increased ASML.
- In Materials we increased Croda and 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.