Wellington US Research Equity Fund

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MARKET REVIEW

US equities finished higher in a turbulent month. Stocks plummeted in the first three trading days of August after deteriorating labor market indicators triggered recession fears and exacerbated concerns that the Fed has waited too long to lower interest rates. However, comments from Fed Chair Powell and economic data released in August did not reveal signs of a rapidly slowing economy, while the Bank of America Global Fund Manager Survey showed that 76% of investment managers believe that the US will achieve a soft landing. Powell set the stage for lower interest rates in September, indicating that inflation has declined significantly, supply constraints have normalized, and labor markets are no longer overheated. The Fed's preferred inflation gauge — the core Personal Consumption Expenditures Price Index — held steady at 2.6% in July and grew only 1.7% on a three-month annualized basis, the slowest pace this year. Current pricing suggests that markets have high expectations for three 25 basis point cuts before the end of the year. According to FactSet, of the 93% of companies in the S&P 500 Index that had reported second-quarter earnings, the blended year-over-year earnings growth rate for the index was 10.9%, well above the 10-year average of 8.4%. Economic data released during the month was mixed. In July, the labor market slowed considerably, but surprisingly resilient consumer spending and consumer confidence and a rebound in the ISM Services Index helped to allay fears of a sharp economic slowdown.

The S&P 500 Net Total Return returned 2.4% for the period. Within the index, nine out of 11 sectors rose over the month. Consumer staples and real estate were the top performing sectors, while energy and consumer discretionary were the bottom performing sectors for the period.

FUND PERFORMANCE AND ATTRIBUTION

- The fund modestly outperformed the index over the month.
- Strong selection in health care, energy and industrials was partially offset by selection in consumer discretionary and consumer staples.
- Within health care and industrials, our top relative contributors were overweights to Eli Lilly and Uber Technologies, respectively. Within consumer discretionary and consumer staples, our top relative detractors were an overweight to Amazon.com and not owning Walmart, respectively.
- Shares of Eli Lilly rose after the company reported second-quarter earnings that surpassed estimates, driven by strong sales of their GLP-1 diabetes and obesity treatments, Mounjaro and Zepbound. The company also raised its full-year revenue outlook by $3 billion, further boosting investor confidence. Shares of Amazon fell after the e-commerce giant reported mixed results for the second quarter. Earnings beat expectations and revenue missed consensus estimates due to cautious consumers choosing to trade down to lower-priced products. Management issued disappointing guidance for the third quarter, citing challenging consumer environment.

FUND POSITIONING AND OUTLOOK

Global indices advanced in the second quarter, buoyed again by significant advances in the select US-based technology companies coined 'Magnificent Seven' stocks. As market participants continue to embrace the potential promise of AI innovation, underlying global economic indicators suggest a market environment defined by an uneven global growth recovery.

In the US, stickier inflation tempers expectations for multiple 2024 rate cuts. We expect grinding progress toward disinflation with shelter inflation remaining a key variable. We view a positive setup for corporate profit growth as cost cutting and efficiency measures outweigh moderating sales growth. However, consensus estimates and valuations remain elevated, increasing the risk of negative surprises. The US presidential election is months away and the potential for significant policy divergence depending on the outcome is top of mind for our global industry analysts.

The European Central Bank cut rates in June, kicking off a cycle of rate reductions as eurozone inflation has moderated but remains sticky. The inflation moderation, along with nominal wage growth, should support real wages for the European consumer, which could lead to a rise in consumption growth from low levels. However, even within the Eurozone, the recovery is uneven with larger economies such as Germany continuing to face structural issues.

In Japan, the yen dropped to a thirty-eight year low compared to the US dollar while the June Tokyo CPI print surprised to the upside. This suggests a higher chance of further policy rate increases by the Bank of Japan, just months after its first rate increase in seventeen years. The potential for continued growth and an increased corporate focus on shareholder return could help broaden global investors interest in Japanese stocks. In China, the range of outcomes remains wide and further policy support is still required to spur a long-term recovery as the consumer seeks to find its footing.

Our GIAs remain focused on identifying investment opportunities across industries and markets and vigilant in assessing potential risks

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