Wellington Strategic European Equity Fund

WELLINGTON MANAGEMENT®

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MARKET REVIEW

European equities slid in October. The eurozone economy expanded by 0.4% in the third quarter, beating expectations of 0.2%, but escalating trade tensions with China and muted consumer confidence contributed to a weak economic outlook. The region's business activity contracted for the second straight month as the HCOB Flash Eurozone Composite Purchasing Managers' Index stabilized at 49.7. Activity in the region was weighed down by Germany's faltering industrial sector, which struggled against costlier energy and weak Chinese demand. Eurozone employment decreased for the third straight month and at the fastest pace since the end of 2020, although the labor market remained healthy amid record-low unemployment of 6.3% in September. Against a backdrop of lackluster economic growth, the European Central Bank (ECB) lowered interest rates for the third time this year, by 25 bps, to 3.25%. Eurozone headline inflation rose to 2.0% in October, up from 1.7% in September, but still meeting the ECB's target and bolstering prospect of another rate cut in December. Core inflation remained steady at 2.7%. The European Union increased tariffs on Chinese electric vehicles to as much as 45.3%, risking retaliation from China. Third-quarter earnings for companies in the STOXX 600 Index are forecast to increase 6.2% from a year earlier, according to LSEG. Germany's economy unexpectedly grew by 0.2% in the third quarter and avoided a technical recession, driven by government and household spending.

The MSCI Europe Index Net returned -3.3% for the month. Within the index, 10 out of 11 sectors declined over the month. Real estate and information technology were the bottom performing sectors, while energy and financials were the top performing sectors for the period.

FUND PERFORMANCE AND ATTRIBUTION

- The fund modestly outperformed the index over the month, however delivered negative returns.
- Sector allocation, a result of our bottom-up stock selection process, was the primary driver of relative outperformance. Allocation effect was driven by our overweight to industrials and underweight to information technology, but partially offset by our overweight to consumer staples and underweight to financials and energy. Stock selection detracted from returns. Weak selection in industrials and financials was offset by selection in materials, health care and consumer staples.
- At the issuer level, our top two relative contributors were not owning ASML Holding and an out of benchmark allocation to Elis, while our top two relative detractors were out of benchmark allocations to Vistry Group and RS GROUP.
- Shares of ASML Holding fell during the period following its third-quarter earnings release. Management revised the company's 2025 net sales outlook downward, citing delays in EUV (extreme ultraviolet lithography) demand due to slower than expected recovery in logic chips, as well as limited capacity additions in memory chip production. The company also reported net income and revenue that beat estimates. Shares of Vistry Group declined during the period due to the British housebuilder understating building costs of some of its developments, leading to a reduction in its annual profit forecasts.

FUND POSITIONING AND OUTLOOK

European markets retreated in October driven by a broader pullback across key markets like France, Germany, Spain and the Netherlands in the lead-up towards the US Presidential Elections and a rally in the US dollar. Market sentiment was mixed on the back of the region's latest inflation reading that trended higher from 1.7% in September to 2% in October. Against this backdrop, the European Central Bank lowered key interest rates by 25 bps over the month. We have noticed regions and sectors within Europe most geared towards rate cuts have started to show some initial signs of economic activity inflecting.

Against this backdrop, 10 out of 11 sectors in the benchmark posted negative returns. Real estate, information technology and materials were among the worst relative performers, while energy and financials held up comparatively well. The value outperformed growth by 260bps this month. We think that many stocks that drove growth equities to outperform in recent years continue to trade at unattractive valuation levels, particularly when looking at their weaker fundamentals. We continue to monitor inflation and longer-term yield levels, recession risk, the situation in Ukraine and the Middle East and the evolving European regulatory framework, as well as the upcoming US elections. We assess companies for their long-term fundamental attractiveness based on our investment criteria and incorporating the implications a recession may have on this. Stocks must fulfil our criteria of a superior structural free-cash-flow and earnings growth outlook and a strong competitive positioning combined with attractive valuation levels. We think that especially as it regards the competitive outlook many so-called growth stocks are currently wrongly priced.

Over the month, we added to existing positions in consumer discretionary and information technology sectors, and repositioned existing portfolio exposures within industrials. On a stock level, we added most materially to our positions in Vistry Group and Rheinmetall, and trimmed Smiths Group and Assa Abloy. We think the portfolio is well positioned, despite the potential for near term volatility.

At the end of the period, our largest overweight was industrials and we were most underweight to health care and information technology. From a market perspective, our largest overweights were United Kingdom and Germany. We were most underweight to Switzerland and France.

RISKS

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PAST PERFORMANCE DOES NOT PREDICT FUTURE RETURNS. AN INVESTMENT CAN LOSE VALUE.

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