# Monthly Portfolio Update

*Amundi Funds II – Pioneer U.S. Fundamental Growth**

*30 April 2018*

EQUITY COMMENTARY

## Market Review

After two consecutive negative months, U.S. stocks posted a modest positive return in April, with the S&P 500 Index returning 0.4%. For the first time in months, there was no discernible difference in the returns of growth and value stocks, with the Russell 1000 Growth Index and Russell 1000 Value Index both returning 0.4% for the month.

Eight of the eleven sectors of the growth index posted positive results for the month; Energy (+9%), Telecommunications Services (+4%), and Consumer Discretionary (+3%) were the best performing sectors while Consumer Staples (-3%) and Industrials (-3%) lagged.

## Portfolio Review

The Portfolio underperformed its benchmark, the Russell 1000 Growth Index. Stock selection - more specifically not owning high growth or high valuation stocks such as Amazon and Facebook, continued to be the primary reason we underperformed the benchmark (not owning those two stocks detracted 0.50% from benchmark relative performance in the month). Sector allocation helped relative performance due to an underweight relative to the benchmark in Industrials, which was the worst performing sector in the month, resulting from concerns about the impact of tariffs on industrials companies.

With respect to individual stocks, the biggest detractor (apart from not owning Amazon and Facebook) was Raytheon, which fell after reporting in line results for the first quarter of 2018 on an operating basis. We believe Raytheon, given its significant exposure to overseas markets, remains best positioned among the defence contractors to benefit from increased defence spending globally and we continue to own shares of the stock. Two other detractors, Colgate Palmolive and Pepsi, underperformed due to weak underlying growth in their businesses. While competition has intensified in Consumer Staples, we believe Colgate Palmolive and Pepsi are well-positioned in the markets they serve and have the potential to generate modest growth going forward.

Among the stocks that contributed to benchmark relative performance in the month were Charles Schwab, Ecolab, and Home Depot. Charles Schwab rose due to solid monthly results that were driven in part, by higher net interest income as interest rates increased. Ecolab increased due to a positive outlook, specifically in its energy business, which should generate higher profit margins if oil prices remain at current levels or more higher. Finally, Home Depot increased due to continued growth in U.S. housing related spending.

## Trading Activity

We added one new position during the month of April and sold two holdings. The new position was Bookings Holdings (formerly Priceline.com), which is one of the world's largest online travel agents which provides accommodation, rental cars and airline tickets. The company generates a high return on growth capital while operating a wide moat business, shown by their scale advantages and strong brands. The company should benefit from the secular growth in online travel as consumers move towards online booking. The stock trades at an attractive valuation and at a discount to our estimate of its intrinsic value.

We sold two health care companies during the month: Alexion Pharmaceuticals and Vertex Pharmaceuticals. Alexion has a strong product portfolio targeted at several rare diseases. We sold the stock because we became concerned that competitors may launch competing drugs in those indications, which could reduce pricing and Alexion's returns on capital. We exited Vertex, which is the leader in treatments for cystic fibrosis, after it had reached our price target.

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# Outlook

We believe the recent increase in market volatility may persist given higher inflation and interest rates, which may ultimately cause economic growth to slow. Given the prospect of higher interest rates, we believe the market should increasingly favour reasonable valued stocks with stable earnings, low financial leverage and high returns on capital as high quality stocks have historically weathered economic and market volatility better than low quality stocks. While high valuation growth stocks with more volatile earnings have continued to outperform the broader equity indices, we believe that rising interest rates and higher market volatility may ultimately pressure valuations of these stocks that, in our view, are overvalued.

The Portfolio remains conservatively positioned with the largest overweight in the Financial sector where we have several holdings with wide moats, high returns on capital, solid growth prospects and attractive valuations. In addition, higher interest rates may boost earnings for some of our holdings. We are positioned differently than other growth strategies, even the more conservatively positioned ones. While this positioning has caused the Portfolio to lag in relative performance, we believe it should perform well relative to its peers, if volatility increases and/or economic growth begins to weaken.

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