Monthly Portfolio Update

*Amundi Funds II – Absolute Return European Equity**
31 July 2018

EQUITY COMMENTARY

Market Review

July was a positive month for the European equity market with the MSCI Europe adding over 3%. Looking at sector level, the recovery we saw in July was broad based with all 11 sectors in positive territory. Healthcare, Industrials, and Consumer Staples were among the top performers, while Energy and Real Estate lagged.

Trade continued to dominate the news headlines, with fears that growing tensions between the U.S. and the rest of the world would lead to sluggish investment and slower export growth. Some of the risks have diminished in recent weeks after U.S. President Trump and European Commission President, Jean-Claude Junker agreed a deal to stave off the impending trade dispute with Europe. This, combined with more favourable FX, better inflation and employment numbers helped to boost sentiment towards the asset class in July.

Perhaps worthy of the most attention was of course the Q2 earnings season for European companies which began in July. As we have been flagging in recent communications, for us earnings delivery remains the key to drive further upside from here. The latest results season (which is around 40% complete at the time of writing) has so far delivered mixed results. Looking across sectors, Consumer Staples and Industrials have enjoyed the broadest beats, while Energy and Consumer Discretionary have fallen short of consensus at this point. However, while earnings have been a little lacklustre to date, we are particularly encouraged by the strong revenue growth being delivered, with top line growth tracking above 6% on a weighted basis which should help to support sentiment towards the asset class.

With periods of volatility and market rotations likely to become more prevalent than we have observed in recent years, we continue to seek balance. Our view remains that the best way to navigate these market conditions is by focusing on compelling idiosyncratic investment cases that we believe have the ability to deliver on EPS and dividend sustainability over the medium-term.

Portfolio Review

The Portfolio delivered a marginal positive performance in July. Looking across the alpha sleeves, the PM book, Healthcare, and Insurance contributed positively. On the other side, Industrials, Consumer Discretionary, and Information Technology detracted.

Within the PM Book, an absolute short position in a cash handling company was a rewarding position. During the month the company reported very disappointing Q2 numbers with a 9% miss versus consensus at earnings level. Looking regionally, Europe continues to be the clear headwind for the company, with performance in the region continuing to slip – this is a key cornerstone of our investment case and we maintain our negative stance on the name. Also of note was another short position in a European auto supplier which underperformed in the wake of the ongoing concerns facing the industry with new emissions regulations coupled with the impending trade tariffs weighing on sentiment.

In Industrials, a long position within French-based capital goods company Schneider Electric detracted following the release of a mixed set of Q2 results. The negative sentiment was as result of disappointment on the price/cost spread and the 1% below consensus expectations for EBITA. We did take some reassurance from the Q2 growth numbers in addition to the supportive commentary around the demand outlook, we continue to hold the name.

Within Healthcare, a long position in biotechnology company Lonza performed strongly. In July, the company reported a very encouraging set of first half results which exceeded investor expectations in terms of both sales and EBITDA, with EPS coming in 9% ahead of forecasts. In addition to the positive results, management comments remained buoyant citing continued strong demand within the Pharmaceutical

*Prior to 16 February 2018, Pioneer Funds – Absolute Return European Equity and Consumer Health divisions with additional projects coming on stream in H2 fuelling medium term growth prospects.

Within Consumer Discretionary, a pair trade between two media companies detracted. On the long side, our holding of Publicis hurt performance after the company reported a disappointing set of H1 results which saw organic growth declining 2.1% during the second quarter versus expectations of a small increase. While margins were solid, thanks to very encouraging cost discipline within the group, underlying business trends weighed on the share price.

Information Technology cost the portfolio some marginal performance in July. Our long position in, technology company Nokia detracted following the release of a somewhat mixed set of Q2 results with top line coming in ahead of expectations while margins were soft. While the weaker margins dampened sentiment, management remained confident that they are seeing improvements in the key “Networks” division and believe that the second half of the year will be more encouraging. The group level guidance has been maintained and we remain holders of the stock.

Finally, within Insurance, a pair trade between international insurer Prudential and a short positon in another leading insurance company was rewarding. Here, it was the short leg of the pair trade that performed strongly following newsflow that the company had experienced a series of compliance and risk failures within the business which was of course a cause for concern for investors.

Outlook

Looking to the second half of the year, we remain constructive on our outlook for European equities. That said, in our opinion, political uncertainty and more muted economic expansion warrant a less bullish outlook when compared to our view as we entered the year.

We maintain our view that earnings growth should be the key catalyst to drive the market higher. One important positive supporting this view is that the recent FX headwinds for earnings may switch to a tailwind in the second half of the year. Additionally, we view the recent positive developments in the trade discussions between Europe and the US as a support for sentiment, albeit that the market requires to see the details before this risk evaporates. For us, perhaps now more than ever, we believe that a strong focus on those companies with the ability to deliver reliable earnings through the cycle, which will be the key to delivering alpha in this environment. With the prospects of rising volatility and ongoing sectoral rotations, we continue to seek balance within the portfolios with no significant sectoral or regional exposures. As fundamental bottom up stock pickers with a medium-term view, we continue to monitor the current situation, seeking to take advantage of valuation opportunities should they arise.

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