Quarterly Portfolio Update

*Amundi Funds II – Global Equity Target Income**
28 September 2018

EQUITY COMMENTARY

Market Review

September is typically a more active month for equity markets as investors return from summer vacations and position their portfolios for the final months of the year. This year, the overall global equity market added marginal gains of 0.5% for the month, taking Q3 gains to over 5% (in USD terms). Looking at Q3, Healthcare, Information Technology, and Industrials were the best performing areas while Real Estate lagged. Regionally, in Q3, the US maintained its leadership with the S&P 500 adding almost 8% while Japan added over 6%, with Europe lagging adding just over 1%.

While headline performance figures in Q3 were quite positive, they mask what has been quite a volatile period for the asset class. Newsflow has been dominated by ongoing concerns about the potential impact of an escalation of a “trade war” between the US and some of its biggest trading partners including Europe and China. While global growth figures released have been robust, with global growth trending around the 4% level, investors are clearly beginning to grow increasingly anxious should President Trump’s protectionist policies dampen this positive trajectory. Adding to this, the economic crisis in Turkey grabbed headlines as the Turkish lira dropped to fresh lows against the USD. Investor’s jitters were felt most within Financials given the exposure of certain (European) banks to the domestic Turkish market. However, outside of the global geopolitical situation, the fundamentals surrounding equity markets globally appear firm, with the latest economic growth indicators showing encouraging signs, while the most recent earnings season has been quite resilient. EPS momentum remains on an uptrend with robust global activity coupled with a weaker euro supportive for earnings into year end.

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 both EPS and sustainable dividends over the medium-term.

Portfolio Review

From an income standpoint, within the portfolio we continue to seek names that offer sustainable income opportunities. Against the backdrop of a rising interest rate environment, within the portfolio we are placing an ever increasing emphasis on dividend growth rather than optical yield. We remain comfortable with the level of income generated to date and are on course to deliver on our 7% target for 2018.

From a performance standpoint, Q3 was a positive period in absolute terms for the portfolio. However, a combination of our overweight position to Europe (more attractive dividends on offer), and the underperformance of some of the higher yielding areas of the market meant that we lagged the broad market index.

As we move further into the final months of 2018, we continue to see three clear themes within the portfolio:

- A focus on debt sustainability – given the rising interest rate environment we believe it prudent to avoid those names which have higher levels of leverage on the balance sheets. We have found some attractive investment cases with this regard in areas such as information technology.
- Seeking beneficiaries of rising rates and steeper yield curves – here we are very selective preferring some well capitalised names within the banking sector.
- Cashflow generation stories – whereby we like names with improving cahflows helping to underpin, and potentially grow dividends going forward. For us, dividend growth will become ever more important going forward.

In terms of portfolio activity, Q3 was a reasonably active period for portfolio changes. Within the autos sector (an area of the market which has been subject to much newsflow in recent months regarding trade tariffs), we added a new positon in Toyota. We are attracted to the company’s favourable position in the US market, strong growth opportunity in China, and

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exposure to emerging markets. In Europe, the company continues to gain share thanks to its innovative hybrid engine offering. On the other side of this trade, we sold our holding of Nissan, preferring the higher ROIC of Toyota. Staying with the auto related names, we sold our holding of tyre maker Bridgestone as a combination of slowing demand and increasing raw material costs are weighing on the profitability outlook.

Staying with the cyclicals, we added a new position in travel company TUI Travel. The share price has been weak in recent months as bookings were lower during the summer months – attributed to the unusually hot weather in the UK (a key customer base). The company has diversified away from this domestic traditional travel business by increasing its exposure to the Cruise and Flight business. While this is more capital intensive in the short-term, it can offer a much more attractive growth profile and less volatility in the business model. We saw the recent share price weakness as offering an attractive entry point into the name.

Turning now to the more defensive areas of the market, we added a new position in Norwegian-based telecoms company Telenor. From a valuation perspective, it looks very attractive. The company has disposed of some of its EM exposure and is enjoying positive trends in some of their key markets such as Thailand, Myanmar, and Pakistan. We increased our exposure to Healthcare. Firstly, we increased our holding of Roche, as we view the recent share price weakness as an attractive opportunity to add exposure. We also increased our holding of US-pharmaceutical company Pfizer as we remain attracted to the underlying business model in the name. On the other side, within Utilities, we are selling our position of RedElectrica. Despite a relatively favourable regulatory environment for the company, we are less convinced that the company will deliver the growth required to justify a strong re-rating of the name.

Finally, from an option writing perspective, we wrote a total of 21 calls and 19 puts during the quarter, with August being the most active month in terms of activity.

Top 10 Holdings	**Portfolio Weight**
Apple	2.7%
ChevronTexaco	2.3%
Microsoft	2.3%
TJX Companies	2.2%
BP	2.2%
Taiwan Semiconductor	2.2%
Royal Dutch Shell (A)	2.2%
Johnson & Johnson	2.2%
KDDI Corp	2.2%
JP Morgan Chase	2.1%

Source: Amundi Asset Management as at 28.09.2018

Outlook

The third quarter of 2018 has provided investors with fresh challenges. A combination of geopolitical unrest in Turkey coupled with ongoing newsflow surrounding the potential impact of a “trade war”, and the more uncertain political backdrop in Italy have certainly weighed on sentiment towards the asset class. While these are of course overhangs in the near team, we continue to believe that the fundamental pillars supporting global equities are largely intact. Looking ahead, we maintain our view that earnings growth will be the key catalyst to drive the market higher given the fuller valuations. From a regional perspective, we continue to favour Europe and Japan from both an income and a relative valuation viewpoint. 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, and sustainable dividends, will be the key to delivering returns in this environment. 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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Date of publication: 3 October 2018

Document ID: 619728