Quarterly Portfolio Update

*Amundi Funds II – Top European Players**
31 July 2018

EQUITY COMMENTARY

arket Review

July was a positive month for the European equity market, with the MSCI Europe adding over 3%. Looking at the 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 over the medium-term.

Portfolio Review

The Portfolio performed slightly behind its benchmark, the MSCI Europe, in July. At sector level, the portfolio had a positive contribution from Consumer Staples and Financials. In contrast, some of our holdings within Industrials and Energy detracted.

Within Consumer Staples, our holding of dairy and water company Danone performed quite strongly. At the end of the month, the company reported a set of quite solid underlying H1 results. Despite the headwinds from the consumer boycott in Morocco and the strikes in Brazil, the company delivered a 7.9% rise in H1 profit, helped by strong cost control across the group which was well received by investors. In addition, our holding of international tobacco company British American Tobacco performed well after the company reported good H1 profit numbers, while both revenues and volumes met expectations. Commentary surrounding the next generation tobacco products (heat not burn technology) remained encouraging, which was an additional support for the name.

The portfolio lost ground within Industrials. Of our holdings, the low-fare passenger airline Ryanair was the main detractor. Ryanair numbers Q1 2019 were in-line with consensus. However, the main negative for the earnings was the softer yield guidance for Q2. This has been moved lower to recognise the impact of strikes and disruption on revenue yields. When passengers are affected by disruptions, the airline tends to reallocate more of its late purchase seats to disrupted passengers rather than being able to sell these potentially lucrative seats. This reduces late booking yields, dragging down the overall pricing. This, combined with on-going news of strike action, created negative sentiment towards the name over the month. Our holding in the global engineering company Smiths Group also detracted as a result a disappointing H2 2017/18 trading statement. The negative news was mainly attributed to the medical division, as a result of product certification delays and two lost contracts in the U.S. We remain positive on the name as we continue to see positive organic growth prospects over the medium term.

The Portfolio gained some ground within Financials, our holding in the Swedish bank Skandinaviska Enskilda Banken (SEB) performed well on the back of better than expected Q2 results. Specifically, SEB's operating earnings exceeded expectations for the second quarter on the back of a broad rebound in activity among its corporate customers. In addition, our holding in the Swiss based diversified financial services company UBS contributed positively following Q2 results that were ahead of consensus expectations on revenues and costs.

The Portfolio lost some marginal performance within Energy as the sector paused for breath after a very strong run in recent months. Of our holdings, Royal Dutch Shell underperformed, the company had a mixed set of results. Shell announced the start of its $25bln buyback programme with an initial buyback target of $8bln starting straight away, which is a positive. On the other side, operating expenses were up 5% Y.O.Y., which was disappointing given RDS's focus on taking out costs. The mixed results combined with a competitor releasing more positive news, weighed on sentiment towards Shell in July.

Finally, the Healthcare sector was a source of positive returns for the portfolio. 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 and Consumer Health divisions with additional projects coming on stream in H2 fuelling medium term growth prospects.

Sector Allocation	Portfolio Weight	Benchmark Weight	Delta
Energy	8.23%	8.27%	-0.04%
Materials	8.34%	8.41%	-0.06%
Industrials	12.57%	13.01%	-0.45%
Consumer Discretionary	11.85%	10.60%	1.26%
Consumer Staples	10.72%	13.43%	-2.71%
Healthcare	19.89%	12.91%	6.99%
Financials	19.07%	19.43%	-0.36%
Information Technology	4.73%	5.54%	-0.81%
Telecommunication Services	3.42%	3.36%	0.07%
Utilities	1.16%	3.64%	-2.48%

Source: Amundi Asset Management as at 31 July 2018.

Portfolio Strategy

The strategy of the Portfolio is highly stock-driven. We believe that business fundamentals drive a share price over time. A bottom-up, research-driven process can potentially add significant value and help us pursue our objective: to buy quality companies, where profitability is undervalued.

Ours is a high conviction approach, which we believe optimises the value of our investment process and we are continuously using our fundamental research capabilities to uncover what we believe to be the most attractive investment opportunities within our investible universe.

Top 10 Overweights	Portfolio Weight	Benchmak Weight	Delta
PRUDENTIAL PLC	4.66%	0.65%	4.01%
ROYAL DUTCH SHELL PLC	6.61%	3.08%	3.53%
CRH PLC	3.76%	0.31%	3.45%
SHIRE PLC	3.98%	0.55%	3.43%
DANONE (EX GROUPE DANONE)	3.68%	0.51%	3.17%
BNP PARIBAS	3.79%	0.78%	3.01%
DEUTSCHE TELEKOM AG	3.39%	0.59%	2.81%
LONZA GROUP AG	2.92%	0.24%	2.67%
BAYER AG	3.74%	1.07%	2.67%
SIEMENS AG	3.79%	1.15%	2.64%

Source: Amundi Asset Management as at 31 July 2018.

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 U.S. 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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