CCLA
GOOD INVESTMENT

For professional investors only

# Better World Global Equity Fund

## Portfolio Manager Commentary – Q4 2024

### Overview

As always, we start this review with a reminder as to what we are looking to achieve for our clients. We aim to build a diversified portfolio that invests in high-quality companies, which can grow cash flows consistently at valuations that are attractive. This should allow us to deliver long-term risk-adjusted returns for our investors. Evidence shows that, over the long-term, stock market returns are derived from fundamentals and earnings growth and therefore we are looking for companies that can, in our opinion;

- demonstrate an enduring competitive advantage,
- benefit from clear long-term growth trends,
- benefit from superior financial strength, with a strong balance sheet,
- are trading at attractive valuations.

The ability of these companies to grow their earnings and compound their cash flows over 5-10 years should, we believe, allow them to drive better investment returns over the long-term.

We are confident in the positioning of the fund as there are reasonable expectations for earnings growth in many areas of the market which we favour. Whilst we remain bullish in the short-term, we are also mindful of valuations being stretched with many stocks priced-to-perfection and we believe stock selection will become ever-more important over the course of 2025 and beyond. As a team, we constantly challenge ourselves as to whether portfolio holdings continue to meet our investment criteria. In many cases, short-term share price weakness can provide an excellent opportunity to add to holdings we favour and, with the fund in continued inflow throughout the quarter, this provided us with opportunities to put this cash to good use.

### Fund performance

Fund performance lagged the MSCI World Index over Q4, returning 2.55% compared to the Index return of 6.94%. Whilst it is always disappointing to underperform the market over any time period, it is important to remember that this is a very short time period and to also understand what has driven these market returns. The biggest drivers in Q4 were growth stocks, cyclical sectors and momentum. Whilst we favour businesses that can illustrate multiple sources of earnings growth, these were not the growth stocks that the market favoured in Q4 which were more built around the potential of future earnings growth, rather than the repeatable and evidenced earnings growth that we favour.

Equally, we would always expect to underperform in a market where cyclicality and momentum are key drivers. Neither cyclical or momentum styles have been shown to be long-term drivers of returns as they are normally influenced by other factors and not repeatable fundamentals that drive markets over the long-term.

The market in Q4, and for 2024 as a year, was also highly concentrated in a few areas that, whilst in the short-term offer the opportunity of potential earnings growth, do not exhibit the qualities we are seeking that can evidence the repeatability of the earnings growth that has been shown to ultimately drive share prices over the long-term.

Consumer

During Q4, we saw good absolute performance in Communication Services and Consumer Discretionary. Shares in Alphabet performed well and we had strong returns from several portfolio holdings including Amazon, O'Reilly and Intercontinental Hotels. The rapid rise of Tesla following Donald Trump's victory represented a headwind to relative performance. Tesla is one of the stocks in the Magnificent 7 that we do not own. Whilst we recognise that Electric Vehicles (EVs) are likely to continue to gain share in car production over time, we see the business model and competitive dynamics within the industry as unattractive. Car manufacturing is a capital-intensive business, meaning that the business has to invest large amounts of shareholder capital in order to generate growth. In addition, there is significant competition, both from established, developed market car manufacturers, but also from Chinese companies that typically have cost advantages in manufacturing. This has more recently manifested itself in a price war in the industry. Corporate governance is also a concern. While the shares rallied strongly in Q4, returning over 100%, on the back of Elon Musk's close relationship with Donald Trump, the underlying fundamentals of Tesla still look extremely challenging. The stock fails many of the investment criteria we are seeking, especially with a valuation of 126x PE.

Consumer Staples

Consumer Staples performance was weak, driven by weakness in the share prices of companies more exposed to China and where potential tariffs under a Trump administration are more likely to be an issue – this included L'Oreal. In addition, as the market pivoted towards a risk-on stance the sector as a whole was left behind in the rally. We still believe L'Oreal should benefit from a growing middle class, leading to secular growth in the beauty industry. L'Oreal enjoy a wide competitive advantage to competitors and we expect will benefit from structural trends in emerging markets. The Consumer Staples sector plays a valuable role in a diversified portfolio of global equities. The sector is defensive in nature, has a low beta and typically performs well when markets fall. Conversely, when markets rise rapidly as we saw in 2023 and 2024, the sector tends to underperform as investors seek growth and leverage to a rising market. Indeed in 2022 when markets fell, the sector was one of the best performing parts of our portfolio and we continue to believe that it will play a strong part in our returns over the coming years.

Healthcare

Healthcare was an area of weak performance in absolute terms. The broad-based weakness across the sector was in response to uncertainty over healthcare policy under a Trump administration amid controversial selections for key regulatory posts.

We remain comfortable that long-term trends within the life sciences industry remain robust. However, we have made some changes to positioning, exiting our position in Humana and reducing our position in United Health, two of the country's largest health insurance companies that

face continued uncertainty around growth, regulation and costs within the healthcare system. On the positive side, we saw good performance from medical equipment companies, such as Abbott Laboratories and Stryker who continue to report good results amid elevated utilisation of the US healthcare system. Novo Nordisk fell in December after disappointing results for its next generation weight loss drug Cagrisema. Demand for existing obesity products remains very strong however, and the closure of the Catalent deal means Novo will have more supply from 2026 onwards. Healthcare benefits from several long-term growth trends with ageing demographics increasing demand, while innovation in areas of genomics, biologics and devices offers the hope of new treatments for disease and better quality of life.

Financials

Whilst absolute returns from Financials were strong, and with good performance in Mastercard, Visa, Tradeweb and CME, we lagged the wider sector as a result of our absence from the US banking sector that rallied off the back of the election of Donald Trump. Whilst we do not have a hardened stance against investing in banks, they are not a sector that easily fits into our quality framework. They are capital intensive, highly leveraged, opaque and largely driven by macro-economic factors. 2024 was a good year for the sector as the market moved from fearing recession to economic optimism amid excitement over the potential for deregulation in the sector under a Trump administration, as well as a recovery in M&A activity. However, this reversal in sentiment is unlikely to repeat and valuations are now considerably ahead of 10-year averages. While we would not rule out holding banks, and we do own HDFC in India where there is clear structural growth in an under-banked economy, we continue to prefer the more predictable and higher margins available elsewhere in the sector.

There is a lot more to the financial sector than the banking industry and whilst there are periods when rapid rallies in bank share prices cause pain on a relative basis, we should be cognisant that they also go through deep downturns/drawdowns that can be highly unpredictable. Indeed, it was less than 2 years ago that we saw the collapse of one of the leading regional banks in North America and the potential collapse of the US banking system without the swift intervention of the authorities and regulators.

Industrials

Industrials performance was marginally negative for the quarter. In capital goods, strength in the US listed names was offset by some weakness in UK stocks such as Spirax Sarco and Ashtead, whilst professional services companies such as Experian and Transunion gave up some gains after a strong run of performance.

Information Technology

Information Technology in the fund lagged the increase at the market level. Whilst we had good performance from Broadcom (leading partner to Google to manufacture their custom AI chips known as ASICS), the renewed rally in Nvidia remained a headwind. Whilst we have been long term investors in Nvidia, we have gone from being overweight vs the market to underweight as a result of its rapid rise in the last two years. Having trimmed the stock at regular points during the rise in share price, locking in significant profits, we believe our weighting reflects both the future share price upside of the company and also the better opportunities we see elsewhere in the market. In software, weak performance across a number of portfolio holdings, including Synopsys, Hexagon, Roper and Intuit, was a headwind as the market focussed purely on trends in AI. However, we believe the investment rationale for all of these businesses is still strong and valuations remain attractive. We also saw

very good performance from Fortinet and ServiceNow that continued to beat market expectations for growth and profitability.

## Activity – Buys

**Epiroc** is a high-quality mining equipment company with industry leading market positions and financial metrics. The world needs metals and minerals for the energy transition and our cities and infrastructure must be developed to serve a growing population. To succeed, we need to speed up the shift towards a more sustainable mining and construction industry. We believe Epiroc can accelerate this transformation

Epiroc has one of the largest direct exposures to the mining industry at c75% of group orders, while also having a significant share of revenue from the aftermarket (>60%). This creates a large, stable and recurring revenue stream in what can be quite a volatile end market. It also boasts industry leading financial returns, with margins of c22% and CFROI of >20%, notably higher than peers who tend to be <20% on both metrics. This signals Epiroc's strong pricing power in the industry and important position within the supply chain, allowing the business to retain its high margins and returns through mining cycles. This pricing power is particularly true within underground mining where half its revenues are earned and is essentially a duopoly with Sandvik. This market position towards underground mining is an additional tailwind as mines are increasingly underground, (from 25% in 2020 to 36% in 2040), ore grades decline (higher asset utilisation required), and miners transition to electrified and automated fleets.

Epiroc is also attractively positioned to longer-term metal demand in Copper and Gold mines, which make up >50% of orders and have structural growth drivers. Anglo American, one of the world's largest copper miners, estimates that to achieve decarbonisation, the amount of copper per capita needs to increase almost 4x with 1.8bt of global copper stock vs c500mt today. BHP estimate that the expansion capex from 2025–2034 is seen as reaching around $250bn, a significant increase from the previous 10 years, when the total spend on copper projects was approximately $150bn. For gold, the higher gold price seen over the last 12 months should support increasing mine output, with the price action largely driven by multi-year themes in de-dollarisation, inflation hedging, and geopolitical tensions.

We increased our positions in ASML, Novo Nordisk and Icon as we continue to believe in the long-term investment case for all and the share price weakness offered us an opportunity to grow our positions at an attractive valuation.

## Activity – Sells

**PepsiCo** was sold after earnings quality declined throughout 2024 as pandemic-era price increases have tapered off and expected volume improvements have not materialised - in fact, volumes have worsened. PepsiCo's international business has shown resilience but remains heavily reliant on price/mix growth, with little to no volume contribution. As a result, we believe there is likely more weakness to come in terms of earnings and have exited the position.

**Nike** has been sold from the portfolio for several reasons. Whilst Nike remains the largest global sportswear brand, the company faces many issues that we do not believe are a quick fix. The company has relied too heavily in the past 5 years on a small number of key franchises that are now waning in popularity, and this has been masking a distinct lack of growth within the rest of the business. However, more worryingly, the competitive position for Nike has deteriorated with the emergence of some now very large competing brands such as On Running, Hoka, New Balance and many others. The company is attempting to execute a turnaround in what is a difficult consumer environment in historically one

of the key growth engines, China, and we do not believe the potential remedies to be a quick fix.

**Starbucks** is another exit. The business has also seen increased competition in China and falling traffic in the US as a premium priced product, as well as operational bottlenecks which will continue to weigh on profitability.

**Humana** has been sold as the company is facing multiple headwinds within its business. Medical costs are likely to continue to rise in 2025 which will hurt profitability of the business. Humana has also come unstuck with the design of its health insurance policies for FY26 and stands to take a significant hit to profitability as a result. We also had concerns over the longer-term investment case. Medicare Advantage is a maturing sector with enrolment now at a significantly higher level than 5 years ago, whilst the tailwind from favourable demographics in the US has begun to ease. In addition, the company has a complicated business model, with little control over its costs in the face of higher inflation and increased utilisation of the US healthcare system and a regulator that looks unfavourably on its industry.

## Looking forward

Since 2018 there have been 6 instances where the MSCI World has fallen greater than 5%, with an average of -11.63% and a low of -26.16%. The CCLA Global Equity strategy only has a 68% downside capture during these times. In the biggest sell offs, (October 2018 to December 2018 and February 2020 to March 2020), we outperformed the index by 4.78% and 9.55% respectively.

To put that into context, a portfolio that held a passive allocation in the worst of those two periods would have needed to return 35.4% to return back to par, whereas the CCLA Global Equity strategy, which returned -16.61% would have needed to return 19.9% to return back to profitability. Whilst there are plenty of reasons to be optimistic, our stance has always been to be aware of protecting our investors' assets on the downside, as well as providing investment returns on the upside.

Whilst we remain optimistic for the portfolio over the short and longer-term, we are also mindful of the 'animal instincts' that have driven markets over the last two years and our valuation-aware approach means that we are conscious that there could be some unwinding of the shares that have driven markets over the last 24 months if the 'best-case' scenario they are priced for fails to materialise. In the event of that occurring, we believe our diversified portfolio, invested in high quality companies with strong fundamentals and multiple sources of growth, will be well-placed to outperform the market.

We thank you for your continued support.

Source: Fund performance source: HSBC as at 31/12/24. Comparator benchmark: MSCI World Index.

**Important information**

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