For professional clients only, not suitable for retail clients.

Sustainable Equity strategies

Quarterly Overview

30 June 2024

Overview

Market overview

The macroeconomic backdrop remain uncertain and political factors have added another element of volatility this quarter. However, broadly speaking, the scene has been set with steady but slowing growth, sticky inflation and slow easing by central banks.

Markets have once again been dominated by interest rates during the quarter, despite little or no movement in this area. 2024 started with expectations that central banks would cut early and cut several times. However, as the year has progressed, those expectations have changed. Inflation data having generally been stronger than expected has left central banks particularly the Federal Reserve to push back against rate cuts. While the European Central Banks cut rates in June, the Federal Reserve and the Bank of England have held off so far. Most central bank forecasters now only expect one or two cuts from each of these banks over the course of 2024 as a whole.

Ahead of the US Presidential elections in November, snap parliamentary elections were called in the UK and France, providing reminders that voter dissatisfaction with the seeming consensus on economic policy and a demand for change from citizens.

Some of the same trends that were driving global equity markets during the first quarter continued into the second quarter of 2024. While the technology sector has continued to outperform, there has been an underlying rally in equity markets with sectors such as financials and utilities also performing well. The technology sector has remained the best performing sector, driven by artificial intelligence (AI) which is triggering significant investments in technology infrastructure – particularly semiconductors. The financial sector benefitted from the diminished expectations of interest rates cuts. Finally, utilities benefitted from increased demand for electricity driven in part by the growth of datacentres. Cyclically sensitive sectors such as industrials and consumer discretionary were among the worst performers, impacted by deteriorating activity data.

In the second quarter, the UK equity market rose 3.7% (FTSE All-Share index) building on the first quarter's 3.6% growth. In overall terms, UK equities (both FTSE 100 and 250) outperformed the Europe ex UK index. Gradually reducing inflation data – with the most recent reading hitting the Bank of England's target – and relative political certainty despite the upcoming elections helped sentiment in the UK. Even before the snap French election announcement dominated headlines, the market impact of the upcoming UK general election had been fairly limited. With polls pointing to a large and stable lead for the Labour party over the Conservatives, markets instead turned their attention to what a potential Labour government would mean for UK assets.

Performance

The Global Sustainable Equity fund underperformed the MSCI All-Countries World Index (ACWI) benchmark during the second quarter. The fund's performance benefitted from its technology holdings which were the top contributors to performance during the second quarter. In particular, companies enabling and exposed to advancements in AI performed well and were amid the top contributors to performance. The world continues to digitalise, transforming the way we live and work, artificial intelligence is the latest iteration of that long-term trend. Semiconductor companies like NVIDIA, TSMC and Texas Instruments performed well in the quarter – these are the key enablers of AI and the ongoing digitalisation trend. Adobe also performed well this quarter and posted strong results – the company is a highly innovative and well-positioned for advancements in AI.

On the negative side, our industrial holdings underperformed, due to overall slowing economic activity data. Examples include precision dispensing machine manufacturer Nordson, specialty chemical distributor IMCD and US water product distributor Core & Main. These names performed well in 2023 and despite the recent cyclical weakness, we believe these remain well positioned over the long term.

Other notable underperformers included US life sciences company Thermo Fisher where its shares were impacted by ongoing weakness from smaller biotechnology customers and a pause in spending from large pharmaceutical companies, and Indonesian microfinance provider Bank Rakyat after the Indonesian macroeconomic environment deteriorated.

We have a portfolio exposed to some exciting and powerful multi-year structural growth themes – the key ones being the ongoing digitalisation of society through things such as cloud computing and AI, which we think we're incredibly early in. We also have exposure to companies enabling the development of a more sustainable and resilient physical world. These include areas such as HVAC (heating, ventilation, and air conditioning), building electrification and more sustainable transport such as rail. We also continue to be excited by the opportunities in the healthcare sector where we observe advancements in computing are accelerating new drug discovery combined with large disease categories such as obesity emerging.

The Sustainable Leaders fund produced positive returns for the quarter, but underperformed its benchmark index over the period. While global stock markets were being driven by the tech sector, particularly the US, the UK market did not enjoy the same tailwind. The driver of markets was a rotation into financials as market expectations for interest rate cuts from central banks fell significantly – signalling that the 'higher-for-longer' environment will play out, leaving banks in a good place to see heightened profits.

Overview

A key detractor for the fund was a positive performance for mining firms in the quarter. Anglo American shares did well following an offer from rival BHP which was later rejected, while Glencore shares also improved as commodities did well in this environment. For sustainability reasons we hold no exposure to these firms. Similarly, another detractor was the energy sector after oil major Shell reported stronger-than-expected results. Despite being a positive contributor in the past, our holding in Sage was a detractor this quarter. Shares of the small business software provider fell following a weak update. The firm helps small businesses with financial software, such as payrolls and accounting, has completed its cloud transition and is seeing a ramp up in demand for its improved AI-related tools giving us confidence in the long-term outlook for the business.

A positive for the fund was Schneider Electric, which continues to benefit from the key trend of electrification, which can be seen in the desire to replace carbon-based energy with more renewable sources. There is also huge demand for power due to the explosion of computation, itself driven by artificial intelligence. Schneider Electric is a leader in electrification and seeing strong demand as businesses look to improve their own electrification processes. Energy company SSE also contributed during the quarter following a positive set of results released in the period. The firm continues to benefit from decarbonisation efforts. Other high quality companies in the portfolio that saw good results and a subsequent rise in share price included Experian and RELX.

Activity

Our sustainable strategies are orientated to those companies that have a net benefit to society and create value for investors through their products and services and the way they manage environmental, social and governance (ESG) issues. Areas such as healthcare and technology remain at the core of the equity portfolios, complemented by engineering, utilities, selected financial services, and companies that lead their industries in ESG performance. This means that we do not invest in some sectors, such as oil & gas, extractive industries, or tobacco. We believe that the exposure to those sectors which offer a positive contribution to society is consistent with outperformance over the medium term.

During the period, the Global fund initiated a new position in British Pharmaceutical company GlaxoSmithKline. The company has gone through a long period of restructuring, investing significantly in R&D, and is starting to see improvements in its pipeline that are not yet reflected in its valuation. Meanwhile, we exited a position in Swiss construction chemical company SIKA as we saw better opportunities elsewhere.

Outlook

Markets have moved significantly over the last 12 months, pricing in peak interest rates, yet history has taught us the macroeconomic environment can change quickly. We are not macroeconomic forecasters and refrain from predicting the direction of interest rates or inflation, but evidence is accumulating that we might be at peak interest rates. However, the path to lower interest rates remains in flux.

While macroeconomics, central bank decisions or politics can have a significant impact on markets in the short term, we believe long-term investors should focus on microeconomic trends, as these will be more important drivers of investment returns over time.

There is a narrative that sustainable investing is becoming less relevant given the economic and political changes we have seen over the last few years, however we believe the drive towards a more sustainable society which we define as cleaner, healthier, safer, and more inclusive continues unabated. When looking at markets we see sustainability becoming more, not less relevant and is illustrated by, but not limited to, trends in digitalisation through artificial intelligence, infrastructure through electrification and healthcare through obesity drugs. These trends make us optimistic about the long-term outlook for sustainable investing.

In an uncertain environment we will continue to follow our disciplined process which has served us well over the years and believe our portfolios are diversified and focused on high quality sustainable and financial companies that are well positioned to drive long-term performance.

Further Information

Please click on the links below for further information:

- Stewardship and responsible investment at RLAM
- Responsible investment
- Royal London voting and engagement
- TCFD climate report

Find out more

In an uncertain geopolitical and economic environment, we recognise the importance of keeping our clients updated on our current investment thinking.

Articles, videos, podcasts and webinars giving the latest views of our investment experts can be found in the Our Views section of www.rlam.com, including regular updates from our Fixed Income, Global Equity, Sustainable and Multi Asset teams.

Important information

Important information

For professional clients only, not suitable for retail clients.

This is a financial promotion and is not investment advice.

Telephone calls may be recorded. For further information please see the Privacy Policy at www.rlam.com.

Issued in July 2024 by Royal London Asset Management Limited, 80 Fenchurch Street, London EC3M 4BY. Authorised and regulated by the Financial Conduct Authority, firm reference number 141665. A subsidiary of The Royal London Mutual Insurance Society Limited.