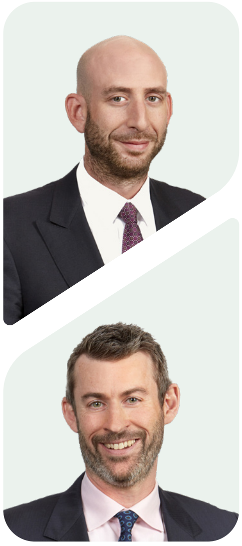
Marlborough



Managers
Tobias Bucks
& Simon Wood

Date
07/11/24

Capital is at risk. Please read full risk warning at the end of this document.

Monthly Commentary: November 2024

Global SmallCap

- Portfolio of 50-80 high-quality small-cap companies selected from developed economies around the world
- Team seek to identify the next generation of global titans before their growth potential has been more widely recognised
- They invest in companies with high-calibre management, expanding into new geographies and bringing new products and services to market

Performance

Fund performance for the month of October 2024 was +4.45%, versus the benchmark return of +1.53%, as measured by the MSCI World Small Cap Index (GBP).

Within the index, Israel and Portugal were the best performing countries, with the US also performing well during the month. Finland was the worst performing country followed closely by its neighbour, Sweden.

In terms of sector performance, the Real Estate sector was the worst performing sector as the US 10-year yield rose during the month. Consumer Discretionary was the second worst performer. Financials was the best performing sector while Communication Services was the second-best performer.

October saw markets pull back on upside US data surprises, a dialling back in excessive rate cut expectations and long bond yields surging on ongoing expansive fiscal policy. Adding to the disappointment was continuing market scepticism as to the effectiveness of China's multiple stimulus announcements (so far lacking in detail since they were announced on September 24), ahead of the critically important National People's Congress Standing Committee meeting scheduled for November. The IMF Asia-Pacific chief recommended that China commit 5% of GDP to stabilise the housing sector, corresponding to RMB6 trillion. Chinese Vice Finance Minister Liao Min, speaking at the IMF and World Bank annual meetings in Washington, said that "the size of this round of policies will be of quite large scale."

On monetary policy, the Bank of Canada cut interest rates by 50bps to 3.75% and New Zealand cut by 50bps to 4.75%. The European Central Bank (ECB) cut by 25bps to 3.25%, with policy remaining sufficiently restrictive for as long as necessary. Since then, there are diverging views being expressed amongst ECB voting officials ahead of the December meeting.

On the data front, real Q3 GDP was stronger than consensus for the major economies. The US grew at a 2.8% quarter annualised rate, the Eurozone registered improving growth of 0.4%q/0.9%y and China expanded at a better than expected 0.9%q/4.6%y.

Global central banks are now clearly in an interest rate cutting cycle. There is the strong potential that the Federal Reserve will continue to cut interest rates into year-end although the cuts will likely be more modest than the 50 basis point cut delivered in September. The reduction and stabilisation of inflation rates globally are providing the justification for these interest rate cuts and ensures that real interest rates do not become excessively high and restrictive for investment.

In November, the election of President Trump was welcomed by the market on pro-business policies compared to higher taxes and other restrictions under the alternative. From an earnings outlook perspective, the US economy is expected to perform well under Trump in 2025, and onshoring policies and protection should be beneficial for the US economy. However, the prospect of a trade war with China and Europe with rising tariffs could be a significant risk to earnings in a number of China facing sectors, including those whose manufacturing base is in China, and those that sell to China including resources. We are monitoring these risks closely, but earnings growth should benefit overall with a pro-business US government.

In summary, the global macro settings are expected to remain within their 'back to normal' levels in 2025. The Fund expects reasonable growth, lower inflation, real rate cuts and a recalibration of restrictive policy settings towards a higher neutral level for this cycle. The fears of a US recession are unsubstantiated. The risk of a sharper slowdown is mitigated by the fact that central banks now have significant room to cut rates. The structural themes of decarbonisation and slowing globalisation continue to underpin activity. In the aggregate, global GDP growth is on a positive upward trajectory towards its trend rate.

Notable positive contributors during October were **Celestica** in Canada and **Powell Industries** in the US. **Hammond Power Solutions** in Canada and **Munters** in Sweden were the main negative contributors.

Celestica is a leading electronics manufacturing services (EMS) and supply chain solutions company headquartered in Toronto, Canada. Founded in 1994, it serves a diverse range of industries including aerospace, defence, communications, enterprise, healthcare, industrial, and capital equipment. Celestica operates a global network of manufacturing and design facilities, employing approximately 25,000 people worldwide. While Celestica serves a diverse set of industries and clients, the Fund expects the business to benefit from the onshoring of high-tech manufacturing back into the US market and the ongoing demand for semiconductor manufacturing equipment. The company delivered a strong result in October as its products linked to data centre demand demonstrated strong sales growth.

Hammond Power Solutions (HPS) is the main manufacturer of dry-type transformers in North America, alongside magnetic products, and related equipment. Founded in 1917, the company has a long-standing reputation for providing high-quality and innovative solutions for power conversion, distribution, and control applications. HPS specialises in designing and manufacturing a wide range of transformers, including low voltage, medium voltage, and specialty transformers for various industries such as industrial, commercial, and utility sectors. The Fund believes that the ongoing investment to upgrade and expand the US electricity grid will lead to large demand increases for HPS' high quality electrical products.

Investment Outlook

The Fund's outlook remains largely unchanged. Global economic growth is expected to be robust in 2024 and into the new year, with the US likely to deliver reasonable GDP growth as ongoing fiscal support remains strong, and unemployment remains low.

The new US administration led by Donald Trump is expected to keep the majority of fiscal spending in place that has been announced over the last four years, including the US Infrastructure & Jobs Act, the Inflation Reduction Act and the CHIPS and Science Act. The Fund is also expecting significant investment from European governments and utility companies into the European grid upgrade in the coming years.

The Fund maintained its holdings in US and European industrials, and its overweight in electrical equipment with exposure to continued investment in the electrical grid in the US and Europe as well as to increased spend in construction and infrastructure. The Fund has decreased its weight to the consumer discretionary sector as recent increases in the 30-year US yield and associated US mortgage rates have put downward pressure on both **TopBuild** and **Installed Building Products** which both have strong exposure to the US housing market. While TopBuild has underperformed recently, the Fund expects these high quality businesses to perform well in the future and benefit from the structural underbuild in the US housing market, especially in the Southern States.

The Fund is underweight the consumer, specifically apparel and core retail exposure as the US and global consumer is still at risk from elevated interest and inflation rates, although these have clearly

Data source: Ausbil and Morningstar

headed lower in recent months. The financial sector is underweight alongside the real estate sector; ongoing elevated interest rates continue to put downward pressure on the earnings of the real estate sector.

On a regional basis, the Fund is overweight the US, Europe and the UK. The Fund is underweight Asia, Japan and Australia.

The Fund remains biased to niche leaders within their industry, like **Powell Industries** (with its significant exposure to electrical switch gear), while still maintaining exposure to areas with structural earnings growth drivers like onshoring and data centre build out, which we expect to deliver earnings ahead of the market. Weaker inflation and employment data points have improved the probabilities of interest rate cuts in the latter half of 2024, particularly as the US Federal Reserve has positioned itself as being data dependent. In general, lower levels of inflation and interest rate cuts provide an attractive environment for businesses to deliver growth. While small-cap stock valuations are trading at significant discounts to large-cap peers, there is good potential for relative outperformance for small caps. We continue to find attractive unrecognised growth opportunities in our universe of under-researched small caps.

Marlborough House, 59 Chorley New Road, Bolton, BL1 4QP

Intermediary Support. 0808 145 2502

Email. service@marlboroughgroup.com

Website. marlboroughgroup.com

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