# Monthly Portfolio Update

*Pioneer Funds – European Equity Value*

*31 January 2018*

Equity

COMMENTARY

## Market Review

The European equity market began 2018 on the same positive trajectory as we saw during the final weeks of 2017. In January, the broad European equity market added over 1.5% led higher by some of the more cyclical areas. At sector level, Financials and Consumer Discretionary were the best performing, while Real Estate, Utilities, and Consumer Staples lagged. To note, the Value Index outperformed (helped by the Financials rally), with the MSCI[1] Europe Value adding c.2.5%.

Perhaps the most prominent event during the month was the January meeting of the ECB. While Mr. Draghi remained quite neutral in his tone, and continued to stress that the ECB would maintain its supportive monetary policy, his comments caused quite an aggressive and somewhat surprising market reaction. Investors appeared to view his comments as being more hawkish than anticipated, and as a result we saw a sharp move higher in bond yields and Euro strength, as equity markets gave back some of the strong performance we have seen during the start of the month. While volatility remains at very suppressed levels compared to historical averages, we did note an uptick in January. This served as a reminder to investors, that the market could be susceptible to short-term swings. For us, the underlying fundamentals supporting the European economy remain firmly in place. Economic data released during the month continued to point to solid growth across the Eurozone, with PMI's remaining at very encouraging levels.

We have long been of the view that earnings growth should be the primary catalyst for the market to move higher from here. January marks the beginning of the Q4 2017 earnings season for European companies. While only a small percentage have reported at this point, the positive earnings momentum that we have seen in recent quarters appears to be continuing. With current valuations becoming fuller, the ongoing evidence of earnings growth is key. We continue to believe that the underlying conditions within the European economy provide a fertile environment for companies to deliver, and developments in January have helped to reinforce this view.

## Portfolio Review

The Portfolio enjoyed a very positive start to 2018, outperforming its benchmark, the MSCI Europe Value. At sector level, the Portfolio had a positive contribution from Consumer Discretionary, Industrials, and Information Technology. In contrast, some of our holdings within Healthcare detracted.

Within Consumer Discretionary, our holding of auto-component and aerospace company GKN was a standout performer. During the month, UK-listed Melrose Industries (an investment company specialised in the acquisition and improvement of manufacturing businesses) made a bid for GKN which caused quite an aggressive move higher in the share price. We remain holders at this point as we await further details of the proposed deal, and monitor the potential for a more attractive offer.

The Portfolio lost some performance in Healthcare. At stock level, our holding of pharmaceutical company Shire detracted following the release of a business update. From our perspective, the new 2020 revenue guidance of between 17-18 billion U.S. Dollar should be seen as quite supportive, albeit lower than the 20 billion previously stated. Sentiment towards the name remains very weak as investors continue to appear concerned about the potential for pricing pressure coming through in the U.S. – especially related to the haemophilia business. Against this backdrop, any marginal negativity can weigh on the stock, as we saw in January. We continue to believe that the company offers an attractive product pipeline, and that the current valuation appears to be very cheap which should be supportive over the more medium-term.

Industrials were a source of positive returns for the Portfolio in January. Our holding of Austrian-based aerospace and defence company FACC continued to be a highly rewarding position. During the month, the company issued a very strong set of quarterly results which showed encouraging growth in both revenues

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and margins. The results pointed to robust underlying performance across all of the key business areas which was well received by investors. In addition, our holding of capital goods company Schneider Electric outperformed. In general, the business trends among the capital goods companies have been solid, with global growth a key support. Results released in January from some key peers suggest that this continues to be the case which was clearly supportive.

In Information Technology, it was our holding of IT consultancy company Cap Gemini which drove the good performance. While company specific newsflow was quite muted, the share price recovered from some recent underperformance helped by the move higher in the U.S. technology stocks given the company's exposure to the region (following the integration of iGate).

Within Energy, our holding of Italian-listed ENI was a rewarding position. As the company has become ever more focused on the core E&P business, it is a clear beneficiary of the higher oil prices we have seen. In addition, the share price underperformed last year, so we are encouraged to see the valuation gap relative to peers beginning to tighten.

Finally, our structural underweight to Financials was a clear headwind for the Portfolio as the sector outperformed. That said, our stock selection was very positive within the sector. Of particular note was the outperformance of Italian banking group Intesa SanPaolo. The company announced that it was considering selling its debt collection arm and a portion of its bad loan portfolio – which represented a shift in strategy. The company's new business plan, set for release in February, will likely put a strong emphasis on further tackling the bad loan issue.

| **Sector Allocation** | **Portfolio Weight** | **Benchmark Weight** | **Delta** |
|---|---|---|---|
| Consumer Discretionary | 14.63% | 8.39% | 6.24% |
| Consumer Staples | 2.57% | 4.08% | -1.51% |
| Energy | 11.82% | 13.30% | -1.48% |
| Financials | 24.69% | 36.61% | -11.92% |
| Health Care | 11.56% | 8.44% | 3.12% |
| Industrials | 13.22% | 7.05% | 6.17% |
| Information Technology | 3.11% | 0.26% | 2.85% |
| Materials | 5.01% | 7.27% | -2.26% |
| Real Estate | 0.00% | 2.31% | -2.31% |
| Telecommunications | 7.45% | 6.62% | 0.83% |
| Utilities | 2.22% | 5.60% | -3.38% |

Source: Amundi Asset Management as at 31st January 2018
Benchmark: MSCI Europe Value

# Outlook

As we enter 2018, we maintain our constructive outlook for European equity markets. We believe, 2017 was a year for the cyclicals, with the more economically sensitive areas of the market driving the rally. Market movements in January saw a continuation of this trend, as economic data and investor sentiment remained on a strong footing. One sector which somewhat lagged in 2017 was Financials, however with the move higher in long-term interest rates that we saw in January, Financial names were the obvious winner. Within the Portfolio we are cognisant of regulatory demands and therefore we remain very selective in our holdings. In keeping with the theme of higher interest rates, much newsflow was centred on the continued strength of the Euro, and the subsequent impact on corporate profitability. For us, the stronger Euro is at least partly the result of improved Eurozone economic fundamentals, and while another significant move higher in the currency would be a clear headwind, we do not see the current level as a threat to our current outlook.

### Important Information



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