Summary

- In dollar terms, the S&P 500 index returned 4.0% in April.
- Gross of fees, the fund returned 6.2%, outperforming its benchmark by 210 basis points (bps).
- We opened positions in 3M and Walt Disney.

Market Background

US equities extended their 2019 rally with a fourth straight monthly gain. The Federal Reserve's ongoing dovish stance, confirmed in its March meeting minutes, and reports of progress towards a US-China trade deal continued to support the market. The rally was given extra impetus by signs of improvement in the global economy and a better-than-expected start to the first-quarter (Q1) corporate earnings season. Against this backdrop, the S&P 500 index returned 4.0% for the month in dollar terms, reaching a record high during the period, and bringing the year-to-date return to 18.2%.

On the economic front, there was brighter news from China and even from the struggling eurozone. The domestic economy, too, appeared to have picked up. US manufacturing activity, retail sales, and job creation accelerated more strongly than anticipated in March, but the most-eye catching number released during the month was the first look at Q1 GDP growth: at an annualised rate of 3.2%, this was well ahead of expectations and marked the strongest start to a year since 2015. While the bumper headline figure helped to allay fears of an impending recession, a significant slowdown in final sales to domestic purchasers (a key indicator of underlying demand) did not go unnoticed.

With analysts having revised down their forecasts ahead of the Q1 results season, the number and degree of earnings surprises were both above their five-year averages, delivering slightly positive earnings growth in the first quarter on a year on year basis.

Performance

In gross terms, the fund returned 6.2% in April, outperforming its benchmark by 210 bps. Security selection was the main driver of outperformance, and allocation effects made a material contribution as well. Our picks in technology delivered a strong return, complemented by smaller positive effects from choices in energy, financials and communication services.

Among individual stocks, the positions in Microsoft, Facebook and Lam Research made prominent contributions to relative returns, in a strong month for both technology and communication services. All three companies also released robust quarterly results during the period, highlighted by a 73% surge in revenue at Azure, Microsoft’s cloud-computing platform. This helped to lift Microsoft’s market capitalisation briefly above $1tn, making it the third company to reach this milestone. While Q1 earnings came in below estimates for Facebook, the company’s stock rose on the back of strong revenues and monthly active-user growth during Q1, as well as news that the company had reserved $3bn against
an expected penalty of up to $5bn by the US government; this sparked optimism that an investigation over privacy practices opened in 2018 may be close to a settlement. Shares in semiconductor company Lam Research soared after it reported Q1 revenue and per-share profit that exceeded its own guidance.

The holdings of UnitedHealth, Edwards Lifesciences and Vertex Pharmaceuticals detracted from returns. We maintained the positions, as earnings published by the three companies were reassuring. In our view, healthcare stocks are vulnerable to bouts of poor performance as the 2020 US presidential campaign intensifies. Drug prices are a recurring target for political rhetoric; investors have also been unsettled by popular support for universal Medicare, as proposed by some leading Democratic candidates. The current campaign is getting under way at a notably early stage, with about 18 months remaining until the election.

Within sector allocation, the underweight in healthcare was the main contributor. Along with the zero weighting in real estate, the overweight positions in financials and communication services were supportive: financials led the market in April, rebounding after poor performance in March, and communication services outperformed the broad market, helped by stellar results from index heavyweight Facebook.

Activity
We initiated positions in diversified manufacturer 3M and entertainment company Walt Disney.

The fund received shares of Dow Inc., and the holding of DowDuPont was correspondingly reduced, as Dow began trading independently, the first step in DowDuPont’s planned separation into three companies. The Dow stock was subsequently sold, and we kept the remaining DowDuPont exposure.

The allocations to technology companies Amazon and Alphabet, oil producer Centennial Resource Development and industrial business Cognex were increased. We took some profits on the exposures to Ebay and Lam Research.

Outlook
The market recovery of the first quarter continued into April, with the S&P 500 index registering a new record high over the month. The correction recorded in late 2018 has now been fully retraced, with sentiment supported by the Fed’s ongoing dovish policy stance and progress in US-China trade talks. Valuations in terms of forward earnings multiples are now in line with historic averages. This seems fair, as the fundamentals for US equities remain solid: the domestic economy is set to expand at trend or slightly above, and we expect corporate earnings to rise in line with historic averages, in the 5-8% range.
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