Candriam Equities L Europe Innovation

Market Overview

Global stock markets took a breather in August, after reaching a high for the year at the end of July. The underlying macro-economic data confirmed a resilient US economy, a strong economy in Japan and a slightly weaker economy in Europe. Meanwhile, the Chinese economy seems to have a hard time to recover and convince the investment community, despite government measures.
Eurostat's flash GDP estimate showed that the euro zone GDP grew in the second quarter of the year. While this pace was relatively modest, the labour market remains very tight, with the unemployment rate dropping in June, its lowest level on record. However, the economic outlook remains uncertain, as the August composite PMI fell to 47, its lowest level (ex-Covid) since 2012.
Unsurprisingly, euro zone headline inflation defied expectations and remained flat in August. Core inflation, however, did fall modestly. While improving, inflation nevertheless remains well above the European Central Bank (ECB)'s target and markets continue to price further ECB rate increases before the end of the year.
The Q2 earnings season is mostly over without having an important positive or negative impact (results and guidance were more or less in line with expectations).

Portfolio Highlights

In August, our strategy did underperform its benchmark.

The main negative detractors to our performance include overweight in Adyen (profit warning), underweight Novo Nordisk (outperformed on positive clinical study in obesity); overweight DSM and overweight Zeiss (mitigated results and question marks on margin trajectory going forward).

During the month, we slightly increased Spirax-Sarco. We feel the risk reward is attractive now, and most of the destocking at **Watson-Malow division should be behind us**.

Outlook

Even if we are closer to the pick, it is still tough to call for how long the FED and the ECB will need to keep very restrictive funding conditions. Core inflation is still too high and the employment markets in both regions are tight. The "Pivot" of the FED (flexibility to inject liquidity) should be observed later in 2024 and more probably in H2. The ECB will follow the FED with a time lag.
Concerning the 10Y US and German Government yields, we should have reached a long-term top, which is very positive for growth sectors and stocks (e.g. Information Technology). The *growth* style has been outperforming the *value* style YTD. We expect the momentum of growth stocks to accelerate. We favour defensive growth going forward (e.g. Health Care, Staples)
Growing uncertainty regarding the impact of high funding costs on the US, European and Global economies for 2023 and 2024. The bottom of the economy should be in H2 2024. Markets are anticipating with a 6 to 12 months advance (somewhere in H2 2023 or H1 2024?). Regarding the bottom, the FED rate cycle will show the way…We are already close to some distress levels for European small caps.
After China "reopening" comes China "back to structural issues". The Investor sentiment has turned from China exposure to Artificial Intelligence exposure.
The global IT sector is leading and supporting the equity markets while commodities and Emerging Markets are suffering from the global slowdown and the risks of trade tension with China in a pre-election year in the US.
European Markets are still significantly under owned by global investors and the level of cash of European investors offers some buffer.

Nevertheless, we still expect some weakness of European and Global Equity markets during the next months before starting the next positive Equity market cycle supported by the liquidity of central banks in 2024 and 2025.