Digital Economy strategy

A challenging month for equities as macro-economic indicators dominates sentiment

- Stubborn inflation data leads to a changing interest rate commentary
- Q1 reports have been strong – 94%[1] of our investments exceeded earnings forecasts
- M&A activity picks up

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What's happening?

Equity markets were weak in April, with the MSCI ACWI declining 3.3%[2], with all sectors delivering negative returns except for Utilities and Energy, suggesting the market continued the preference towards more defensive / value names that began in March. The fund's growth bias resulted in an underperformance compared to the broader equity market during the month.

In the US, headline inflation is proving stickier than anticipated whilst the employment market remains robust, resulting in a varied message, including from the US Federal Reserve, raising concerns on when interest rate cuts might happen with the suggestion that rates may remain elevated for longer, in line with our previously stated view. However, Jerome Powell also suggested that it was "unlikely" that the Fed would need to raise interest rates any higher.

First quarter earnings season has started. For those companies in the MSCI ACWI Index that have reported their results, 51%[1] have reported better-than-expected revenues and 59%[1] reported better-than-expected earnings. For the Fund's investments, these figures are 68%[1] and 94%[1] respectively.

Portfolio positioning and performance

Our 'Discovery' sub-theme provided positive returns during the month, supported by a strong set of results from Alphabet (the owner of Google and YouTube), who exceeded expectations on both top line growth and profitability measures. Additionally, the company initiated the payment of a dividend to shareholders and an additional share buyback authorisation that were received favourably.

[1] Source: Bloomberg as of 30/04/2024
[2] Source: Bloomberg in USD as of 30/04/2024

The cybersecurity segment of our 'Delivery' sub-theme also provided positive returns as two of our investments in the space became acquisition targets. Hashicorp has been bid for by IBM, at a 43%[3] premium to the share price before take-out rumours began to drive the share price higher. Subsequently, Darktrace announced they had received another bid from private equity firm, Thoma Bravo, valuing the company 20%[3] higher than the pre-bid market level.

Detractors to the portfolio during the month included industrial real estate company Prologis, who reported mixed results and reduced guidance as it is facing softer near-term fundamentals. We believe the long-term outlook remains intact driven by the continued demand for modern logistics space.

Our investments in the 'Data & Enablers' sub-theme were also weak during the period as several of our enterprise software holdings such as Salesforce.com, ServiceNow and Workday were subject to selling pressure due to concerns that enterprise IT budgets are under pressure given the challenging macro environment. Whilst this has yet to show up in reported results, management teams continue to provide conservative outlooks, fuelling the market's concerns.

We sold the position in Twilio, the provider of a communications platform that enables developers to integrate a wide variety of messaging and voice services into their applications. Whilst the company has exhibited significant growth over the last 5 years, their ability to expand profitability has been disappointing and the share price has reflected this. We see better investment opportunities elsewhere.

Outlook

Following a strong first quarter, equities weakened in April. Uncertainty has risen with recent economic indicators being more mixed whilst the upcoming election cycle in the US throws additional noise into the current environment.

Whilst company reports have been good during the first quarter, we note the potential for a return to a "risk off" environment as we enter the summer months. We are mindful that focusing on identifying strong businesses with long term growth drivers and opportunities remains key during periods like this and this supports our philosophy when focusing on the opportunity supporting the digital economy theme.

As stated previously, it is likely that the "what will the Fed do next" trade will continue to dominate market sentiment in the upcoming months. Whilst the inflation numbers certainly suggest that we might have seen the peak in the current interest rate cycle, we are of the opinion that rates could stay higher for longer and therefore need to be mindful that the market might be factoring several cuts in the coming 12 months. Political gyrations could also have significant bearing on investor sentiment in 2024 as the US returns to the polls in November whilst military events in the Middle East continue.

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[3] Source: Bloomberg as of 30/04/2024

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