Robotech strategy
Demand trends improve in some of the more industrially focussed or cyclical parts of the portfolio

- Q1 earnings season: >85% our holdings have beaten earnings expectations so far
- Hyperscaler CAPEX trends continue to be very strong
- We see signs of stabilization in trends of demand for analog chips

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What's happening?

Global Equity markets fell in April, with the MSCI All Country World Total Return Index declining 3.3%[1] in USD terms. Economic data continued to be mixed in the US in terms of inflation trends, with the market now expecting the start of interest rates cuts in the US to be pushed out a little. In addition, Geopolitics impacted markets during the month with hostilities in the Middle East weighing on investors risk appetite.

The Q1 earnings season has now commenced and corporate earnings results have so far been encouraging. Approximately half of the companies held in the strategy have reported earnings results so far and of those that have reported, greater than 85%[2] of the holdings in the portfolio have beaten earnings expectations compared to 57% for the broader market as measured by the MSCI ACWI Index. The earnings beats have been broad based across the strategy, spanning our Technology, Industrial and Healthcare holdings. We have seen an interesting improvement in demand trends in some of the more industrially focussed or cyclical parts of the portfolio such as Japanese Automation companies and Analog Semiconductor companies which have highlighted that after a more difficult period of softer demand and dealing with inventory digestion - trends are stabilising and prospects for the second half of 2024 are better.

Portfolio positioning and performance

The Robotech strategy underperformed the MSCI All Country World Index during the month, with the Technology sector lagging the market and sectors that we don't have exposure to in the strategy such as Energy, Consumer Staples, Utilities and Materials being more resilient.

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

We saw strong earnings outlooks and results from a number of our Japanese automation holdings during the month. After a period of weakness due to higher levels of inventory and more muted demand from China, activity at these companies appear to be improving. Keyence performed well when it reported record sales and earnings in the quarter which is notable given that we are only at the early stages of a cyclical recovery in the industry. Mitsubishi Electric's Share Price rose 16%[3] after reporting record earnings and orders and provided encouraging guidance for the upcoming fiscal year. Elsewhere Nabtesco, which has seen more challenging performance lately reported better than expected results and its share price bounced.

Hyperscaler CAPEX trends continue to be very strong as Microsoft, Alphabet (Google), Meta Platforms (Facebook), Amazon and others continue to invest heavily in the infrastructure and computing power needed for Artificial Intelligence. The big four all increased CAPEX intentions for 2024 and there were some comments on 2025 being a further year of growth in spending. The levels of spending here give additional visibility in to the demand trends for many of our holdings making or selling AI chips, (such as Nvidia, Broadcom, TSMC and AMD) as well as companies in the portfolio that are benefitting from greater levels of Semiconductor CAPEX (such as ASML, Applied Materials, Daifuku and Teradyne)

Elsewhere in semiconductors, we have seen signs of stabilization in trends for demand for Analog chips. The industry had built too much inventory and has been going through a period of digestion over the last couple of quarters due to weaker demand from automotive and industrial companies. We saw strong results during the month from NXP Semiconductor and more comments around demand improving - both from companies held in the strategy like NXP Semiconductor and their peers ST Micro and Texas Instruments which aren't held.

In the healthcare space we saw strong results from Intuitive Surgical, who have commenced the launch of their next Generation of Surgical Robot – Da Vinci 5. Da Vinci 5 is the first major new platform launch from the company in a decade and comes with compute power that is 10,000 times faster than the prior generation. The new launch doesn't appear to be disrupting sales of the prior generations of Robot and Intuitive Surgical increased their guidance for annual procedure volumes to grow 14-17% in 2024[4].

Results have generally been good across the portfolio during the period. However, we saw a weaker share price performance from Dexcom (Diabetes Monitoring) where the results looked solid, but perhaps didn't match heightened investor expectations. One other area of softness continues to be large scale warehouse automation projects, with Kion and Autostore citing slower decision making from customers and occasional project delays. There are some signs of encouragement however, with Autostore seeing an improvement in customer ordering activity during the quarter and Zebra, a supplier of warehouse automation equipment seeing an uptick in demand.

Within the semiconductor space we added to positions in ASML (Semiconductor Equipment) and Broadcom (AI chips). ASML reported a good set of results but the shares underperformed due to weaker customer ordering during the quarter. We recognize that quarterly ordering patterns always have some variability, particularly when it relates to lithography machines that cost several hundreds of millions of dollar each. The management team at ASML reiterated their confidence in current business trends and we used the weakness to add to our position. We funded these top ups by reducing our position in Qualcomm which has been a solid performer so far this year.

We added to our holding in Keyence, a Japanese manufacturer of machine visions systems and components, following share price weakness and continued to build our position in Zebra a supplier of automation equipment used in warehouses. In the Healthcare space we added to our position in ThermoFisher where there are signs that after a period of softness for the business, demand trends have started to improve.

[3] Source: Bloomberg in USD as of 30/04/2024
[4] Source: Q1 2024 INTUITIVE da Vinci 5 Conference Call, 18/04/2024

We exited our position in Shockwave Medical following a bid for the company from Johnson and Johnson. We have seen a reasonable amount of M&A activity in the strategy so far this year, benefitting from bids for Shockwave Medical (Medtech), Axonics (Medtech), Ansys (Industrial Software) and Marel (Automated Food Processing). There has also been confirmation from Schneider Electric that it is a the preliminary stage of a deal for Bentley Systems (Industrial Software). After a period of more limited M&A activity for companies held in the strategy, it is interesting to note the activity so far this year.

Outlook

The Q1 earnings season has been encouraging thus far, with strong CAPEX trends coming from the semiconductor industry and signs of an improving Industrial economy. During 2023, it was apparent that inventories had been accumulated following the supply chain challenges and the slower than anticipated recovery in Chinese investment activity meant there was a lengthy process for these excess inventories to be worked through. We saw the March Institute for Supply Management (ISM) Manufacturing PM turn positive for the first time in 16 months indicating expansion in the US after quite a lengthy period of contraction. We have also noted other indications of industrial activity such as Japanese machine tool orders continue to recover in 2024. We would note that these data series often exhibit some volatility and would avoid reading too much in to monthly fluctuations, but it is encouraging to see the improvements and we will be carefully watching this trend over the coming months to determine the shape of the recovery in the manufacturing sector.

Moderating inflation has supported equity markets in 2023 and whilst inflation remains above target in the US and other key markets, CPI in the US is down very notably from the 9.1% seen in June 2022. The prospect for a “soft landing” in the US appears more likely with economic data holding up more resiliently than forecast and the labour market remains relatively strong. There continues to be labour shortages that present a real challenge for businesses. For instance, in the manufacturing space or warehousing space, we see fewer workers – particularly younger demographics – that are willing to do these kinds of jobs, given the nature of the roles and the salary. As a result – facing labour inflation and labour shortages – companies are increasingly incorporating Technology and Automation in their processes to increase efficiency and productivity with their existing/shrinking workforce. In simple terms, we anticipate that labour shortages and wage inflation are substantial drivers of automation demand over the next few years. As labour costs go up, the payback periods become quicker from introducing automation, meaning that more and more areas are considered for automation.

The US is trying to reinvigorate its domestic manufacturing via infrastructure spend and capital expenditures (CAPEX). This is important politically as its US Jobs, important geopolitically as it keeps US intellectual property within the US and important for supply chain as its secure stock within the country after the disruption witnessed post-COVID. Government support has evolved over the past few years, whether it be the Trump Administration – with tariffs in the US China trade war – or more recently with the Biden administration and the CHIPS Act signed to ramp up and ‘reshore’ US technology such as domestic semiconductor manufacturing. US president Biden also passed the Inflation Reduction Act (IRA) and other acts allocating a lot of spend for more domestic US manufacturing, focussed on key technologies. As a result of tariffs, incentives and reducing the risk of supply chain issues, companies are investing again in the US and this comes with technological sophistication, robotics and automation. Whilst these acts were signed in to law a while ago, (Infrastructure Investment and Jobs Act in November 2021, Chips and Science Act in August 2022, Inflation Reduction Act in August 2022), very little of the allocated budget has been distributed and this support isn’t anticipated to peak until 2026.

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