August monthly commentary

September 14, 2022

Major equity indices fell in August, putting an end to what now appears to have been a bear market rally in July. The twin forces of hawkish central banks and growing fears of an economic slowdown continue to weigh strongly on markets. The main act this month was Fed Chairman's Jackson Hall address which quashed any hopes for a dovish pivot any time soon, triggering the sell off.

American and European indices were in the red in August, giving up roughly half of the July gains. In the US, the hawkish Fed drove both the tech heavy NASDAQ and the S&P500 down by –4.6% and –4.2%, respectively. European indices were a touch worse, with the EuroStoxx 600 down –5.3% on fears of a looming recession. Asian markets fared better with China's Shanghai Composite recording a decline of just –1.6% while Japan's Nikkei was the only major global index in the green at +1.0%. Despite these challenging market conditions the

Talaria's Global Equity Strategy delivered a solid month, minimising losses to just -0.64% versus -2.54% for the benchmark while maintaining substantially lower market risk.

Across sectors the decline was broad-based. Cyclicals underperformed with Information Technology and Consumer Discretionary down –6.0% and –4.6%, respectively. Defensive sectors fared better with Utilities and Staples down just –1.8% and –3.0%. The exception this month was Healthcare, down a considerable –6.1% driven by the passage of legislation in the US that controls drug prices as well as some idiosyncratic adverse litigation. Energy was the only sector in the positive (+1.2%), supported by continuing geopolitical tensions.

The Fed strongly asserted its hawkish stance at the annual Jackson Hall speech pushing the yield on the US 10 year back up to 3.19%, a 55 bps increase for the month. The switch to a risk-off mode pushed the VIX up 5 points to 26 while concerns around demand slowdown brought the price of oil down for a third consecutive month by –9.0%. Despite the weakness in oil, the broad-based commodity index was flat, supported by strong gas prices in Europe. AUD/USD –2.0% weaker for the month.

McKesson, A US-based drug distributor, was the biggest contributor to performance for the fund in August. A strong Q1 result catalysed share price outperformance. The company upgraded its guidance and now expects significantly better top line growth (+4% to +7% vs 0% to +4% previously) and improved EPS outlook for the full year. The shares are trading at 15x next year's P/E, still offering attractive value in the face of a challenging macro backdrop.

French-based pharmaceutical giant Sanofi was the biggest detractor to performance this month. There were allegations that Zantac, a popular medicine used to reduce stomach acid production, was a carcinogen. The news had a big negative impact on the many owners of the drug since its inception in 1983. The specific impact on Sanofi is uncertain but we estimate that a very bearish outcome would be a still manageable $11bn post-tax settlement. Sanofi generates $5bn of cash flow post dividend so it can absorb a fine of this scale within a couple of years without an impact on its debt position. We still like Sanofi's defensive characteristics and view the $10bn drop on the day of the announcement as more than sufficient.

August was a sharp reminder that equity markets remain in difficult territory. They are caught between the rigours of inflation and vulnerable earnings whilst still not having adjusted to reflect this in valuations.