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December monthly commentary

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Global equities gained in the fourth quarter, snapping their worst losing streak since the GFC. Investor sentiment improved from near all-time lows and the risk-on trade was back with cyclical sectors that provide high yields performing the strongest. But with no change to hawkish central banks' policies, sticky inflation and a slowing global economy, the medium-term outlook continues to be challenging.

The fourth quarter finally brought some respite to financial markets. Improvement in sentiment from the September lows and easing energy prices in Europe renewed a risk-on trading environment. Equity markets were up across the globe with cyclical sectors outperforming. Volatility eased and the US dollar declined against a basket of major currencies. Inflationary pressures and central bank hawkishness remained but the market shrugged off their impact on economic activity.

Across all regions, old economy, high cash yielding cyclicals outperformed while tech underperformed. This dichotomy was most evident in the US where the broad-based S&P500 (up 7.1%) significantly outperformed the tech-heavy NASDAQ (down 1.0%). Indices in Europe, dominated by old economy stocks and helped by easing gas prices, gained the most in absolute terms. Germany's DAX and France's CAC were up 14.9% and 14.3%, respectively. Asia lagged, partly driven by lockdown induced economic uncertainty in China (Shanghai index up 2.1%). Japan's NIKKEI was up just 0.6% after several quarters of stronger relative performance earlier in the year.

Talaria's Global Equity Fund delivered a positive quarter, gaining +4.65% while maintaining lower market risk., taking the 12-month performance to +8.27%.

Distributions: The Talaria Global Equity Fund paid a December 2022 quarterly distribution of 7 cents per unit taking its 12-month income return to 7.28%.

Higher-beta sectors (energy, industrials, materials, and financials) outperformed in the quarter, gaining between 15.4% and 18.6%. Growthier sectors underperformed with IT up just 4.9%. Defensive sectors were all up low double digits. The standout underperformer and the only sector in the red was consumer discretionary (down 2.5%), driven by the terrible performance of its two largest constituents – Amazon (16% weight, down 25.7%) and Tesla (6.6% weight, down 53.6%).

Investor sentiment improved in the fourth quarter, helped perhaps by a loss of 4.7% in the value of the USD against a trade-weighted basket of currencies. The VIX dropped 10 points from 31.6 to 21.6, near the lows of 2022 and in line with its 30-year average. The US 10-year yield at 3.87% remained elevated but almost unchanged versus Q3 as monetary policy remained hawkish in the face of high inflation. The broad-based commodities index and oil specifically were both up by just one percent but gas futures, particularly important in Europe, came down by 35%.

The fund's holding in Mexican-based retailer, Fomento Mexicano Economico (FEMSA) was the biggest contributor to performance this quarter. In addition to its strategic holdings in global brewer Heineken (14.8%) and the world's largest Coke bottler, Coca-Cola FEMSA (47.2%), FEMSA owns one of the world's largest convenience store networks with some 20,000 'OXXO' branded sites across Mexico. This network delivers strong same-store sales and good margin expansion. We still see upside to the stock, even after share price strength.

Japan-based security provider SECOM was the biggest detractor this quarter. While recent results have been disappointing, the company remains a leader in the Japanese security market (online monitoring). There is an opportunity to optimise the P&L while the balance sheet remains strong. The company is attractively priced, and we have added further to our position in the past three months.

During the quarter, the Fund initiated new positions in US-based distributor Henry Schein and UK-based distributor Bunzl and made no exits.

Henry Schein is the largest distributor of consumables, equipment, and software to dental practices globally. In addition to its dominant market position (~35% share), its excellent track record on M&A, a strong balance sheet, very stable customer base and ability to pass on inflationary pressures are all reasons we believe Henry Schein can continue delivering EPS growth consistent with its long-term average of ~13%. Given an attractive starting valuation (currently trading on a 7% Free Cash Flow yield), we think the stock is well placed to deliver good upside for shareholders.