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January monthly commentary

February 16, 2023

January was a stellar month for equity markets, brushing off a difficult 2022 to start the year with newfound optimism.

Helping fuel some of this bounce back was the depressed level of investor sentiment at the end of December, as well as the seasonal benefit from the 'January effect' where last year's laggards lead performance. Perhaps the most notable example of this has been Tesla whose stock is up 58% since 1st January (albeit still down 52% since its peak in November 2021).

On the macro front, easing headline inflation prints and more mixed economic data proved to be a source of confidence, supporting those of the view that central banks have successfully tamed inflation with rate rises set to start moderating. Investors also cheered the expected boost to global growth from China's re-opening after the abandonment of its COVID-zero policy in late December.

All of this has resulted in headline grabbing returns with lots of commentators noting that the NASDAQ has had its best January since 2001, up 10.7%. Investors who take this as a positive should probably avoid looking at the subsequent two years' performance.

Across other US markets performance was also strong with the S&P500 and S&P600 Small Cap Index up 6.2% and 6.7%, respectively. European bourses delivered impressive rallies with the French CAC up 9.4%, followed by the German DAX, up 8.7%, and UK FTSE, up 4.3%. Asian markets didn't miss out either with the Chinese Shanghai Composite Index up 5.4%, followed by Japan's Nikkei225, up 4.7%.

Most sectors finished positive for the month, however there was wide dispersion between top and bottom performers. Consumer Discretionary, Telecommunication and Technology were all clear beneficiaries of the rate slowdown dynamic, each finishing up more than 10% in January. Materials were also up 10% on expectations of a pick-up in demand following China's reopening. To fund this risk-on sentiment, investors sold defensives, including Staples (+1%), Utilities (flat) and Healthcare (-1%).

The AUD rose 3.6% against the USD, while the Bloomberg Commodity Index finished down 0.8%, and WTI down 1.7%. VIX fell 2.27 points to close at 19.40, along with yields on US 10yr Treasuries which fell 36bps to finish at 3.51%.

Chinese technology giant, Alibaba, was the biggest contributor to performance in January. The shares re-rated on news of improving relations with regulators, and an expected pick-up in momentum post China's reopening. Given the stock still trades on a ~9% FCF Yield (based on our estimate of normalised earnings) with scope for more capital management courtesy of better cost control, focus on cash flows, M&A discipline, and a solid balance sheet, our bottom-up work suggests there is more upside.

The Fund took advantage of recent share price weakness to re-establish a position in US-based CF Industries. As the world's largest ammonia producer, we believe CF's assets are of immense strategic value given their application in food security and clean energy advancements. More near term, CF has benefitted materially from recent widening of global gas spreads resulting in FCF likely to top $3bn for the next two years (vs ~$1bn in more normal years). While these returns are clearly not sustainable, we were able to buy the stock at levels we think offer compelling value on a through-cycle basis. Additionally, the company is now almost net cash with management announcing a ~$3bn buyback out to FY5 (~18% of the market cap).

The Fund also took advantage of the broader strength in equity markets to trim exposure to certain securities, including fully exiting its position in Italian bank Intesa, and selling calls across its entire holding in chip manufacturer, Intel. While we shy away from making predictions, we do find it hard to share the market's rosy outlook as our bottom-up work continues to suggest that this year will be challenging.