March 2023 Quarterly Performance

On the face of it global equities had a good first quarter, extending a rally that began last October. Dig deeper, however, and a more complex picture emerges. Sticky inflation initially kept pushing bond yields up, which eventually contributed to the demise of banks in the US and Switzerland and to further tightening in monetary conditions. This, coupled with warmer European weather and underwhelming Chinese growth, dampened global demand prospects, pushed commodities lower and eventually led to lower bond yields. The equity rally that ensued was notably narrow with just eight US mega-cap tech stocks driving two thirds of the entire quarter's worth of MSCI World index gains.

An eventful first quarter of 2023 was a tale of two halves. The first half started with a cyclicals and growth equities' rally in January supported by lower yields and lower commodity prices. A risk-off February quickly followed as yields rose on the back of renewed inflation worries and hawkish central banks. The second 'half' came abruptly at the start of March when three regional banks in the US failed. The result was a drop in yields, underperformance in financials and a bounce in a concentrated set of big-winner, rate-sensitive growth stocks.

Despite the noisy start to the year, all regions saw equities close the quarter in the green. In the US, the epicentre of the banking crisis, the tech-heavy, rate-sensitive (and financials-lite) NASDAQ returned 16.8% and significantly outperformed the broad-based S&P500 Index (up 7.0%). In Europe, one of the main drivers was a collapse in gas prices which pushed all major indices up despite weakness in financials. Germany's DAX and France's CAC were up 12.2% and 13.1%, respectively. UK's FTSE100 (heavy in both financials and energy stocks) was notably weak, up just 2.4%. In Asia, Japan's Nikkei delivered a solid 7.5% while China's Shanghai Composite returned just 5.9%. Initial excitement of China reopening in January was a damp squib and gave way to weak performance in February and March.

Against this messy backdrop, Talaria's Global Equity Fund delivered a positive quarter, gaining 5.98% in AUD while maintaining substantially lower market risk. Strong positive portfolio breadth (24 stocks advanced and only 6 declined), a few positive idiosyncratic stock events and limited exposure to financials and energy stocks helped drive the performance.

Growth sectors, dominated by a narrow list of mega-cap Tech stocks, were the biggest winners in the quarter as rates fell. IT, Telcos and Consumer Discretionary all returned strong numbers in the range of 16-21% in the quarter. Next were traditional cyclicals that started the year strong but eventually weakened as banking wobbles and recession fears resurfaced. Industrials and Materials closed the quarter up 5-7%, with European Industrials a standout, up 12.5% and helped by much lower gas prices. On the other extreme within cyclicals were energy (down –4.3%, impacted by lower oil and gas prices) and financials (down –2.2%, impacted by banking woes in the US and Switzerland). Defensives underperformed with healthcare notably weak at –2.1%.

Warmer weather in Europe, weaker China and banking sector worries in the US dampened demand and drove commodity and energy prices lower in the quarter. The Bloomberg Commodity index declined –6.5% while the benchmark WTI Crude oil price fell –5.7%. Rates also fell on the back of a deteriorating economic outlook while policy uncertainty remained high. The US ten-year bond yield was down 40bps to 3.47% in the quarter. The US Dollar also weakened 2-4% against several other major currencies. Paradoxically, policy uncertainty has driven rates and FX volatility higher while volatility in equities has declined with the VIX down to 18.7, 3 points lower than at the start of the year.

The fund's holding in Mexican-based retailer Fomento Mexicano Economico (FEMSA) was the biggest contributor to performance this quarter (see our Stock in Focus section). Other large contributors to performance for the quarter include Hong Kong listed Alibaba (announced plans to split into 6 business units), French-based pharmaceutical giant Sanofi (successful Phase 3 result on Dupixent drug) and Japanese-based automation manufacturer Mitsubishi Electric (improved demand for its products).

SANOFI

The list of detractors this quarter was notably short with only two that carried a material impact to performance. Both were pharmaceutical giants with negative idiosyncratic outcomes. US-based JNJ announced a large potential financial hit for a litigation case in relation to talc. Swiss-based Roche had poor outcomes from its drug pipeline that drove the price lower. Despite weakness, we continue to see upside to both names and have been increasing our exposure.

During the quarter, the Fund initiated a position in US-based HRB (an undervalued franchisor that provides assisted income tax return preparation services in the US, Canada and Australia) and re-initiated positions in CF (a US-based fertiliser manufacturer that benefits from a wider spread between European and US gas prices), Loews (a US-based holding company with a stake in CNA, a US-listed insurer, that trades at a significant discount to book value) and Henkel (a European Household and Personal Care products manufacturer). The only exit at the very start of the quarter was Italian-based bank Intesa.