Monthly Market Commentary

October was a difficult month for global equity markets as broad-based selling took hold across geographies and sectors.

There were plenty of reasons for this, but one which was probably weighing disproportionately on equity valuations was the ongoing rise in 10-year US government bond yields because higher rates reduce the present value of future cash flows, all else being equal. While both inflation expectations and expected short term rates have played their parts in lifting 10-year yields, the main recent driver has been a rise in 'term premium', which is the extra compensation investors demand for holding longer term versus shorter term bonds. Given the parlous state of US finances and political uncertainty it is hardly a surprise that investors want more payment for taking on the risk.

Downbeat outlook commentaries from a wide range of corporates this results season also caused some investor angst. Hershey flagged a weak Halloween season, Hasbro cut full year sales guidance for a second time this year and UPS also cut guidance thanks to weaker package demand and higher wages. Budget travellers are also feeling the pinch with US low-fare carriers slowing capacity growth as travel demand fades. Even luxury customers are feeling pain with Porsche warning that inflation/rates are dampening car buying, while distiller Remy Cointreau flagged weaker-than-expected US demand for high-end spirits. In short, there is growing evidence of pressure on corporate profitability.

On a regional basis, US small caps bore the brunt of October's sell-off with the S&P Small Cap Index falling 5.8%. US large caps fared better with the S&P500 and NASDAQ down 2.2% and 2.8%, respectively, outperforming major Asian and European bourses, almost all of which fell more than 3%.

The AUD was 1.5% lower against the USD, with the Bloomberg Commodity Index down 0.2% and WTI down 11%. VIX rose 0.6 to close at 19.86 while yields on 10-year US government bonds rose 36bps to close at 4.89%.

With investors in sell-mode, it was no surprise to see Utilities top the leader board as the only sector in the green, finishing up 0.5%. Staples and Technology also fared well, falling a relatively modest 1.8% and 0.9%, respectively. Energy was down 4.4% on oil price weakness, while Consumer Discretionary fell 4.8% on the back of some disappointing megacap updates, notably Tesla flagging more product discounting. Healthcare was another source of weakness, down 4.8% despite its defensive attributes.

France's largest drug-maker, Sanofi was this month's biggest detractor as news of changes to its capital allocation priorities saw the stock fall sharply. Taking advantage of its superior revenue visibility to the end of the decade, and rock-solid balance sheet, Sanofi will now be embarking on a program of higher organic R&D spend rather than M&A. While this adds some complexity for those modelling near term trends, we think it was the right strategic decision to make, and one which only serves to further boost the company's longer-term value proposition.

As disappointing as the share price performance has been, the reality is that the business carries no financial risk, current sales continue to grow at a reasonable pace, and the stock is now exceptionally cheap in our opinion. For example, the difference between the current value of Sanofi's patent protected cash flows and the market's valuation of the company is approaching €90b. Put another way, the market is pricing Sanofi stock as if the business will spend €90bn on R&D, or almost a decade's worth of investment, and generate nil value. We think this is far too pessimistic, particularly if you consider that since 2013 every €1 of R&D spend at Sanofi has generated €3.40 of value. Taking advantage of this share price weakness, we have therefore decided to accumulate more exposure to Sanofi stock at prices we think are very attractive.

At the other end of the performance spectrum, was the Fund's holding in global catering and rewards group, Sodexo. Shares rallied on a solid set of FY2023 results that highlighted organic sales continue to grow strongly across the group. Should the company execute on its FY2025 targets we think Sodexo stock could be worth ~€150/share.

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