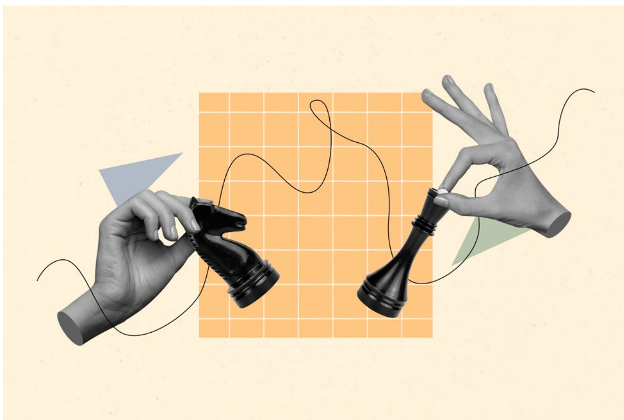
J O Hambro
Capital Management Group

JOHCM Continental European Fund

Q2 2024 MARKET REVIEW

Fund Literature	Fund Facts	Views & News

Political uncertainty has outweighed economic improvement



Market Review

Strong growth data are holding back cuts in interest rates

The quarter was dominated by the waxing and waning of the central banks, which generally moved in a more hawkish direction. The ECB stole a small lead on the rate-cutting theme after the cut by 25bps in June to 3.75%. The Fed, having been priced to cut rates by seven times in 2024 at the turn of the year, now foresees (going on the current dot plot forecasts) just one cut in the next six months. Inflation has generally remained stickily high; in Europe, headline inflation ended the first quarter at 2.4%, just 0.1% higher than at the end of the second quarter. The latest ECB staff forecasts expect 2.5% headline inflation this year and 2.2% in 2025, with core inflation converging with headline next year. Eurozone GDP surprised on the upside in the first quarter, at 0.3% QoQ, leading to full-year revisions to the current 0.7%, whilst the ECB now forecasts 0.9%. Growth in the US slowed markedly in the first half of the year versus the incredibly strong annualised performance in the last quarters of 2023. European PMI data remained mixed, with manufacturing seeing no improvement, whilst the services PMI rose from 51.5 in March to 52.8 in June.

Source: Bloomberg.

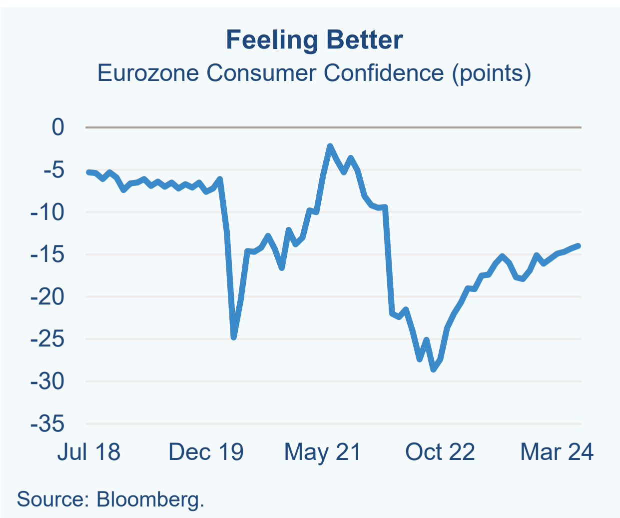
April saw a strong move up in bond yields, with US inflation remaining high and the ECB staying data-dependent. The earnings season in April and May brought positive impetus in Europe, and we have seen index upgrades of around 4% year to date. China remained a notable weak point when it came to company trading comments, but we saw the implementation of stimulus for the property market during May. Tariffs were imposed on the import of Chinese vehicles into the US, and we expect to see this happen in Europe as well.

The European parliamentary election in June was not expected to be a market moving event and in itself resulted in the People's Party remaining the largest grouping, expanding their number of seats to 26%, whilst the Renew and Green groupings were the main losers. Ursula von der Leyen has been nominated for a second term as President. However, the key event was in France, where Macron's allies received only 15% of the vote, whilst the Rassemblement National captured 32%.

The President immediately dissolved the French Parliament and called for fresh elections, in which the RN did relatively poorly but for which there was otherwise no clear outcome. The French stock market underperformed by 5% in June and bond yield spreads immediately moved outwards, this is after the ECB had already placed France under the excessive deficit procedure.

Over the quarter remarkably few sectors outperformed, and many were relatively close to the benchmark, against the index (non-12pm adjusted) falling 1% in euro terms. Healthcare outperformed by a significant 7.1%, followed by technology at 6.1%. Consumer discretionary was the largest underperformer by 9.9%, with materials, staples, real estate, and financials all underperforming between 3.5% and 5%.

At the half-year stage, this leaves technology as the pronounced outperformer by nearly 18%, followed by health care at 7%. Leaving consumer staples and utilities underperforming by around 13% each. The other dominant theme was that of the narrowness of the market, mainly in the US, where the Magnificent 7 became the Magnificent 5, and the AI-driven rally continued.



Source: Bloomberg.

Current Positioning

Allocation is driven by expectation of lower rates

At the end of the first half of the year, the largest overweights were in communications, industrials and technology. We remained underweight in financials, consumer discretionary and energy. The move to further underweight in financials reflects the start of the downward shift in interest rates, leaving the banks looking cheap but intrinsically trading on peak earnings, which investors will start to look through. The increase in the industrials weighting reflects our commitment to the energy efficiency theme and a slight increase in our exposure to European cyclicality, where we see the construction markets bottoming with a likely upturn in 2025.

Outlook

Political change is unlikely to derail economic recovery

Europe remains the home of many fantastically positioned global companies which are being held back by being quoted on a low-multiple market. We think the overall earnings outlook is pretty good and one of incremental improvement over the next year. European growth is on an overall improving trend, in fact, to above-trend levels in 2025, whilst we await the gradual improvement in global trade and business investment.

The disinflationary outlook will likely allow the ECB to reduce rates in the direction of 3% by the end of the year, stealing a march on some of its developed market peers. This will benefit businesses and consumers alike, even though leverage is low and consumer savings rates are above normative levels.

Recent noise stemming from France is likely to be a temporary sideshow. We think it likely that a slight risk premium will shadow France, given the likely budgetary direction versus the ECB's wishes, aside from the inflammatory nationalistic overtones. Politics generally is likely to continue to occupy the centre-stage as we head towards the US elections

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and confront the China tariff realities; market volatility will likely be on the rise.

Portfolio-wise, we continue to like our thematically backed winners and remain attuned to where valuations are most conducive. We think selective noncyclical stocks offer nice growth at very reasonable prices, penalised by the current higher level of interest rates. We have carefully added a couple of more European-focused cyclicals, which will leverage off the incremental macro improvement. This is a time for selectivity and focus while recognizing the overall journey of improvement that the European stock market is on.

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