Quarterly Portfolio Update

*Amundi Funds II – European Equity Value**
28 September 2018

EQUITY COMMENTARY

Market Review

September is typically a more active month for equity markets as investors return from summer vacations and position their portfolios for the final months of the year. This year, the overall European equity market added marginal gains of 0.5% for the month, taking Q3 gains to over 1%. Looking at Q3, Healthcare and Energy were among the top performing areas, while Real Estate and Telecommunication Services lagged.

While headline performance figures in Q3 were far from exciting, they mask what has been quite a volatile period for the asset class. Newsflow has been dominated by ongoing concerns about the potential impact of an escalation of a “trade war” between the US and some of its biggest trading partners including Europe and China. While global growth figures released have been robust, with global growth trending around the 4% level, investors are clearly beginning to grow increasingly anxious should President Trump’s protectionist policies dampen this positive trajectory. Adding to this, the economic crisis in Turkey grabbed headlines as the Turkish lira dropped to fresh lows against the USD. Investor’s jitters were felt most within Financials given the exposure of certain European banks to the domestic Turkish market. Closer to home, in September, we saw a resurgence of Italian political uncertainty as the government scramble to enact budget legislation which meets the demands of the EU in terms of the permissible deficit. While no clear outcome is visible at this point, the market is beginning to demand a higher risk premium for holding Italian assets – a reflection of the heightened uncertainty.

That said, it was not all bad news. We have long been of the view that the key catalyst for the European market to push higher from these levels is earnings growth. Looking at the most recent Q2 earnings season, we remain encouraged by the underlying performance of European corporates, and we continue to see EPS growth for 2018 in the region of 9% which should be a key support. Our view remains that the best way to navigate these potentially more volatile market conditions is by focusing on compelling idiosyncratic investment cases that we believe have the ability to deliver on EPS over the medium-term.

Portfolio Review

The Portfolio underperformed its benchmark, the MSCI Europe Value, during the third quarter of the year. At sector level, the portfolio had a positive contribution from Financials and Materials. In contrast, some of our holdings within Consumer Discretionary and Industrials detracted.

Within Financials, our holding of Nordic banking group Swedbank performed well. In July, the company delivered a strong set of Q2 results which showed better profits on the back of higher income from trading activities and lower credit impairments which helped to underpin the share price. Staying with the Nordics, our holding of DNB also performed well as investors appeared to prefer the higher quality banks with strong capital positions in the wake of the heightened volatility we saw during the period.

The portfolio lost some ground within Consumer Discretionary. At stock level, our holding of auto-component maker Continental detracted. During the month, the company issued a profit-warning whereby it downgraded its guidance. This caused some nervousness amongst investors which appears to have been somewhat exacerbated by the poor sentiment towards the auto sector at this point. While the news was disappointing, we maintain our position) as we remain comfortable with the underlying business model with a medium term view. Additionally, our holding of auto supplier Faurecia detracted as sentiment towards the auto sector deteriorated further given the ongoing newsflow concerning both the impact of a potential trade war, and the changing regulations facing the auto industry.

In Materials, our holding of Dutch-listed nutrition company DSM continued to perform strongly. In July,

*Prior to 16 February 2018, Pioneer Funds – European Equity Value.

the company reported solid results with EBITDA growth in excess of 10% (helped by one off effects). Looking ahead, the company's management expects to grow above market during the second half of the year, with strong demand helping to underpin revenue growth into year-end.

The portfolio lost some ground within Industrials. Our holding of international staffing company Randstad detracted. In general, there is a concern in the market that organic growth for the staffing industry is slowing compared to recent quarters which has hurt sentiment towards these names. We believe that this is fully reflected in valuations and we remain encouraged by the operational performance within the company. More positively, our holding of Austrian-listed aerospace and defence company FACC performed well following the release of good quarterly numbers. Revenues for the group showed an increase of 4.4%, while cashflow generation continued to be solid, with over 14 million euros of FCF during the period.

Within Healthcare, our holding of Bayer has underperformed in the wake of the initial unfavourable ruling by a US court concerning compensation to a claim that one of the key products has been the cause of cancer. We have reviewed our investment case and we believe that the share price reaction has been too strong and we remain holders of the stock at this point. More positively, our holding of international pharmaceutical company Shire continued to perform strongly. At the end of July, Takeda (the acquirer of Shire), reported a good set of Q1 results which came in ahead of consensus expectations.

Finally, the portfolio lost some relative performance within Information Technology. of note was the underperformance of IT consultancy company Cap Gemini. While the company reported very solid H1 results which came ahead of expectations, the company's full year guidance implies a slowdown in the second half of the year which appeared to cause some nervousness for investors. For us, the company's growth profile remains robust and remain comfortable with our investment case.

Sector Allocation	Portfolio Weight	Benchmark Weight	Delta
Consumer Discretionary	11.18%	6.68%	4.50%
Consumer Staples	2.23%	6.27%	-4.04%
Energy	13.64%	16.87%	-3.23%
Financials	26.16%	31.92%	-5.76%
Healthcare	11.98%	12.32%	-0.34%
Industrials	15.07%	4.64%	10.43%
Information Technology	1.88%	1.11%	0.77%
Materials	2.81%	6.24%	-3.43%
Real Estate	0.00%	2.54%	-2.54%
Telecommunications	5.64%	5.25%	0.39%
Utilities	2.75%	6.17%	-3.42%

Source: Amundi Asset Management as at 28 September 2018
Benchmark: MSCI Europe Value

Outlook

The third quarter of 2018 has provided investors with fresh challenges. A combination of geopolitical unrest in Turkey coupled with ongoing newsflow surrounding the potential impact of a “trade war”, and the more uncertain political backdrop in Italy have certainly weighed on sentiment towards the asset class. While these are of course overhangs in the near team, we continue to believe that the fundamental pillars supporting European equities are largely intact. Economic data coming out of the Eurozone has shown a stabilisation, with PMI numbers remaining firmly in expansionary territory. Our view remains that GDP growth for the Eurozone should be in the region of 2% in 2018 with a weaker euro a clear tailwind as we move towards the end of the year. Turning to earnings, which for us remains the key catalyst for the market to move higher, we can take some solace from the most recent Q2 reporting season which showed European companies continued to deliver – most notably in terms of revenue growth. We believe that this positive EPS momentum alongside the cooler valuations in the market should act as a support going forward. As fundamental bottom up stock pickers with a medium-term view, we continue to monitor the current situation, seeking to take advantage of valuation opportunities should they arise in the wake of bouts of short-term volatility.

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