CARMIGNAC PORTFOLIO GRANDCHILDREN: LETTER FROM THE FUND MANAGERS

11/10/2023 | MARK DENHAM, OBE EJIKEME

-3.6%

Performance of Carmignac Portfolio Grandchildren A EUR Acc[1] over the third quarter of 2023 vs. -0.5% for the reference indicator[2]

+15.9%

Year-to-Date performance of Carmignac Portfolio Grandchildren vs. +12.0% for the reference indicator

1%

Carmignac Portfolio Grandchildren is ranked 1st quartile over 1 and 3 years period for its Cumulative return within its Morningstar Category[3]

*During the third quarter of 2023, the total return of **Carmignac Portfolio Grandchildren** (A share class) was -3.6%. This compares to a return on the funds reference indicator of -0.5% over the same period.*

MARKET ENVIRONMENT

The market environment was dominated by ever rising bond yields everywhere, despite inflation steadily falling in most regions. The message from policy makers was unhelpful with, for instance, the Federal Reserve confirming that interest rates will stay "higher for longer" and the policy rate is likely to remain above 5% for the whole of next year, 2024. This was a more hawkish prediction than most market participants hoped for. This dynamic and messaging created a short-term headwind for our portfolio where relatively highly rated names especially in the Technology/Medtech and Life Science sector, despite their quality, have lagged markets generally in the period. In addition, the financial sector is seen as benefiting from higher rates and was relatively strong during the period. Also, as oil prices rose from 75$ to 95$ a barrel, the Energy sector outperformed. Neither energy nor financial stocks meet our demanding criteria of quality and sustainability, and so we have no exposure to these sectors. We maintain the long term focus we have for Carmignac Grandchildren fund, and a focus on high quality stocks, and we have made no changes to the investment process. In fact, we believe as economic growth and profit growth forecasts are likely to weaken into 2024, the relative visibility of our quality names should stand them in good stead in the coming months.

PERFORMANCE COMMENTARY

For the most part company results for our holdings over last 3 months have been fine – especially during the second quarter reporting season, as you would expect for the quality companies that we focus on. However, in August and September we had a small number of either disappointing results or corporate announcements which led to some dramatic and high-profile movements in stock prices, as well as some positive surprises too. Of course, from time to time this happens, but it is highly unusual to have so many such events in a short period of time.

Adyen, the electronic payments processor reported a disappointing level of growth in their first half results – “only” growing 19% when expectations were higher. More worryingly they referred to high level of competition on price for digital payments especially among large e-commerce clients. This resulted in a 40% stock price drop and further falls afterwards. Thankfully we had already sold most of our holding before this, after a strong performance earlier in the year, and we only had a holding size below 1% on the day – but we saw the news as thesis changing and we sold out completely afterwards.

More significant was Orsted which was a 2% holding in the fund. The wind farm developer which for a long time has had ongoing supply chain issues hindering profitability, especially among recently awarded US contracts, announced a surprise set of write downs and profit warnings. This was a surprise as a Capital Markets Day (CMD) with investors a few weeks earlier had presented a more optimistic picture, and we thought had drawn a line under the issues. Clearly things have deteriorated faster than we or even the management thought. The stock fell dramatically -25% reflecting the surprise. Again, owing to a deterioration in the thesis we sold out of our holding.

A little less dramatic but still a setback was the reaction to Oracle’s quarterly results in early September. The numbers were fine but guidance into the next quarter was a little disappointing. This is a name buoyed by artificial intelligence (AI) enthusiasm and expectations were very high, with the stock having risen 60% year to date at that point, so the name was vulnerable to a pullback, which we saw, of c12%. Nonetheless we retained our position in the company. 80% of its revenues currently are high visibility subscription revenues growing high single digit p.a. plus its datacentre business, OCI, is best placed to benefit for demand for AI applications – and bookings there are extremely strong. In passing, we retain high conviction among several names exposed to the AI theme: Microsoft where we will soon get more tangible visibility of the AI opportunity with the launch of their O365 co-pilot. As well as semiconductor chip maker Nvidia, Oracle, and to a lesser degree publishing software company Adobe.

Finally, life science co Lonza fell 15% after announcing they had parted company with their CEO. The name has been struggling with several operational issues dragging on for longer than expected. It may be these issues continue for a little while longer, but we retain our position in the name. Their core business, which accounts for about two thirds of profits, namely manufacturing biologic drugs, remains a good one and is set to drive low teens growth for many years, and we expect medium term guidance at a forthcoming CMD to underline that. Also even factoring in near term lower growth the stock price is undervaluing the medium-term opportunity dramatically.

It has not been all bad news though. Novo Nordisk continues to perform exceptionally well, and it rose 20% in the period helped by a clinical trial read out confirming a better than expected 20% reduction in cardiovascular risk for patients on weight loss drug Wegovy. This should lead to higher and accelerated demand for the drug as well as increasing insurance coverage of the product. We maintain more than 15% exposure of the fund to the theme of treating obesity through Novo and US firm Eli Lilly.

PORTFOLIO ADJUSTMENTS

Trading in the quarter was modest overall. Our focus remains on identifying and owning the profitable companies with high return on capital companies we believe have the best prospects for a 5 year or longer time horizon and holding stocks over this time.

[1] Performance of the A EUR acc share class ISIN code: LU1966631001.

[2] Reference indicator: MSCI World Index (Reinvested net dividends).

[3] Source: Morningstar as of 29/09/2023.

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