ClearBridge
A Franklin Templeton Company

Global Value Improvers Strategy

Grace Su
Managing Director, Portfolio Manager
ClearBridge Investments, LLC

Jean Yu, CFA, PhD
Managing Director, Portfolio Manager
ClearBridge Investments, LLC

Key Takeaways

- Global equities rose in May, spurred by stabilising inflation indicators in the U.S. and largely positive corporate earnings.
- Europe Ex UK was the strongest performing region, while the Japanese market detracted in light of continued weakening of the Yen and its negative impact on the economy.
- Geographically, Europe and UK are attractively valued and could see the most rapid fundamental change with lower power prices, better manufacturing activities, and a healthy consumer all contributing to sequential improvement.

Market Overview

Global equities rose in May, with the MSCI World Index returning 0.74% (in local currency), spurred by stabilising inflation indicators in the U.S. and largely positive corporate earnings. Continued investor enthusiasm for AI and AI-related companies helped drive strong performance in growth stocks, with the MSCI World Growth Index returning 5.70% (in U.S. Dollars), further extending its year-to-date lead versus the MSCI World Value Index by 252 basis points. In the UK, Prime Minister Rishi Sunask called for a new national election several months earlier than expected, spurring a late month pullback in UK equities over increased political uncertainty. Despite an increase in industrial output on the back of additional government-backed funding, the Chinese economy continued to see lacklustre performance in May as several retail and consumption indicators came in below expectations. In the U.S., Fed officials voted to keep interest rate levels unchanged for the sixth consecutive time at the Fed's May meeting, following firmer than anticipated inflation indicators over the last several months. While Fed Chair Powell acknowledged that it may take longer than previously anticipated for inflation to cool enough to justify reducing interest rates, he reiterated his belief that the Fed's current stance is appropriate.

Within the benchmark, Europe Ex UK was the strongest performing region while the Japanese market was the sole detractor in light of continued weakening of Yen and negative impact of the currency on the economy. By sector, communication services was the greatest contributor to monthly performance, while financials also positively contributed benefiting from a continued push-out of rate cut expectations and the prospect of a higher-for-longer interest rate environment. The health care sector was the main detractor from performance.

Portfolio Highlights

Against this backdrop, the ClearBridge Global Value Improvers Strategy outperformed its benchmark for the month.

On a regional basis, stock selection in Japan and North America and an overweight allocation to Europe Ex UK were the top contributors for the month, primarily driven by the rebound of the renewable value chain.

By sector, utilities and industrials were the greatest contributors to monthly performance as companies participating in the renewable value chain delivered strong returns, as the market priced in higher demand for power and for grid investment from additional AI demand. Beneficiaries generated strong returns, including AES, Brookfield Renewable and NextEra Energy in the utility sector and Hitachi, Nexans and Veolia in the industrial sector. Hitachi (0.36%), a Japanese industrial electronics conglomerate, continues to benefit from strength in its IT division from digitisation initiatives across its customer base and deliver record bookings thanks to the need by customers to modernise energy transmission infrastructure globally. Nexans, a French industrials company that makes cable systems for offshore wind farms, subsea interconnections, power transmission, telecom networks, fiberoptics and electrical systems, was also a leading contributor for the month.

Stock selection in the financials sector was the largest detractor, as some idiosyncratic near-term developments including merger uncertainty with the Spanish bank BBVA and credit concerns about our Indonesian bank BRI.

American-based PayPal (-0.26%) and Coty (-0.26%) were the largest individual detractors from relative performance. PayPal (PYPL), in the financials sector, is a leading digital payments provider. The company's share slipped lower during the month as the stock reversed some of the strong performance last month from strong Q1 financial results and some regulatory proposals that would subject PayPal's BNPL, or Buy Now Pay Later, business to the same consumer protection requirement as credit card companies face.

Coty (COTY), in the consumer staples sector, is a global beauty company comprised of a market-leading prestige fragrance business and mass cosmetic business. The company reported a fiscal Q3 with results in line to slight ahead of the expectation. However, management's fiscal Q4 guidance was disappointing due to year ago results inflated by inventory restocking.

During the month, we did not initiate any new positions or exit any existing holdings.

All returns are in local currency.

Positioning and Outlook

Despite a moderate market pullback due to expectations of sustained high interest rates, strong economic growth and a robust labour market support a positive global equity market outlook. We see delays in central bank easing as more of a timing issue because higher-than-expected inflation reading seems to be driven by price adjustments in certain categories rather than a reacceleration in overall prices. As we expected in our last monthly commentary, the attractiveness of renewable companies started to be recognised by the market with our renewable exposure being the largest contributor of our outperformance in the month, which we expect to continue. Power prices have risen alongside higher capital costs to preserve returns, and we expect renewable energy producers to play a major role in meeting the growing power demand driven by AI datacentre buildouts. Geographically, Europe and UK are attractively valued and could see the most rapid fundamental change with lower power prices, better manufacturing activities, and a healthy consumer with excess savings all contributing to sequential improvement.