INTERNATIONAL LONG-TERM UNCONSTRAINED

A market is built on fundamentals

MARTIN CURRIE
A Franklin Templeton Company

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Recent short-term volatility has been elevated

Style volatility has been very high over the past 18 months, as the market digested a seismic shift in interest rate policies. This reflects the exceptionally elevated inflationary pressures post Covid. The changes in interest rate expectations and the pressure on quality growth assets has been extreme.

Rising inflation and rapid rate hikes in 2022 marked the third calendar year ever in history where bonds and equities fell in tandem. Within equities, value outperformed on the back of rising yields, whilst quality growth stocks sold off heavily due to the long duration nature of these businesses.

This significant and rapid style leadership shift away from quality and growth, towards value, has created volatility. However, growth and quality factors combined have outperformed the market in the long term (chart 1).

Chart 1. Price performance of Global Equity, Growth, Quality and Value segments

Source: Martin Currie and Bloomberg, October 2023. Global equities represented by MSCI ACWI Index. Style segments represented by MSCI ACWI Growth Index, MSCI ACWI Value Index, MSCI ACWI Quality Index.

Quality growth stocks are resilient in the face of uncertainty

A focus on quality growth stocks is our core investment philosophy. We invest in companies with solid balance sheets, high returns on invested capital, low disruption risk, that operate in industries with favourable dynamics for value creation, and have exposure to structural growth opportunities. These companies typically emanate long duration characteristics, given their superior returns and cash flows, and long-term growth prospects. Therefore, they carry bond-like characteristics.

Rising interest rate expectations tend to lead the market to sell down or out of long-duration assets. This is in favour of those with shorter duration, including the value-oriented parts of equity markets. It can result in a pronounced and persistent style rotation, which is the situation in markets currently. During style rotations, there can be significant valuation anomalies, resulting from divergence between company fundamentals and market sentiment. This creates opportunities for long-term investors like us. Ultimately, we are confident that after knee-jerk style shifts, markets will return to fundamentals. We believe that the long-term fundamentals of the businesses that we hold in our clients' strategies remain intact and undervalued by the market.

Uncertainties remain, but we believe the headwinds for long duration quality growth stocks should recede as interest rates peak. Profitable, quality growth stocks with high returns on invested capital and strong balance sheets should fare well in such elevated uncertainty:

- **Earnings resilience** – protects against the risk of ongoing earnings downgrades
- **Pricing power** – protects margins in a stickier inflation environment
- **Solid balance sheets** – provide better protection in case of recession
- **Structural growth opportunities** – provide opportunities in a low-growth environment

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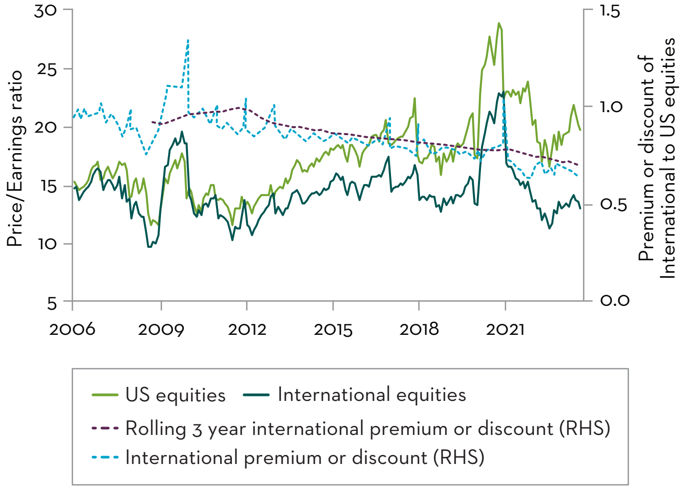
Fundamentals remain supportive for quality growth stocks

International equities look attractively valued, compared to US equities. In addition, they are currently at a discount to the three-year average discount.

Chart 2. Historic valuation of International and US equities



Our focus on quality growth companies enables us to identify the pockets of the market which we believe to have the most potential to outperform in the future. These show superior growth profiles to the international equity market as a whole.

Source: Martin Currie and Bloomberg, October 2023. International equities represented by MSCI ACWI ex USA. US equities represented by MSCI USA.

Our focus on quality growth companies enables us to identify the pockets of the market which we believe to have the most potential to outperform in the future. These show superior growth profiles to the international equity market as a whole. Although the valuation of the portfolio remains elevated relative to the market, we believe this is justified by the greater growth potential.

	Portfolio	International equities
Price Earnings (NTM)	24.4	12.3
EV/EBITDA	16.3	8.6
Net debt/EBITDA	0.6	1.4
Revenue growth (NY 5 CAGR)	12%	3%
EBIT growth (NY 5 CAGR)	13%	5%
EPS growth (NY5 CAGR)	12%	6%
DPS growth (NY5 CAGR)	11%	4%
Free cash flow growth (NY5 CAGR)	16%	9%

Source: Martin Currie and FactSet as at 30 September 2023. Representative Martin Currie International Long-Term Unconstrained account shown. Please note that this strategy is unconstrained by any benchmark. We show it against the MSCI ACWI ex USA for illustrative purposes only.

In the context of the global style shift, we believe that the market will ultimately re-align to company fundamentals. With our long-term approach, this presents an attractive growth opportunity in international equities.

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- Investing in foreign markets introduces a risk whereadverse movements in currency exchange rates could result in a decrease in the value of your investment.
- This strategy may hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the strategy's value than if it held a larger number of investments.
- Smaller companies may be riskier and their shares may be less liquid than larger companies, meaning that their share price may be more volatile.
- Emerging markets or less developed countries may face more political, economic or structural challenges than developed countries. Accordingly, investment in emerging markets is generally characterised by higher levels of risk than investment in fully developed markets.
- The strategy may invest in derivatives Index futures and FX forwards to obtain, increase or reduce exposure to underlying assets. The use of derivatives may result in greater fluctuations of returns due to the value of the derivative not moving in line with the underlying asset. Certain types of derivatives can be difficult to purchase or sell in certain market conditions.

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