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# MARKET INSIGHT – KEEPING FAITH WITH FUNDAMENTALS

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In this article, Roy Leckie, Executive Director – Investment and Client Service, shares his thoughts on recent market developments and highlights the enduring importance of company fundamentals.

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An autumnal chill has spread through global equity markets in recent weeks. Key to the pivot in sentiment was the dawning realisation that the Federal Reserve is not yet ready to dial down its fight against inflation. Jerome Powell's hawkish words at the Jackson Hole Economic Symposium in late August might not have been followed up with a September rate hike, but investors nonetheless appear to have resigned themselves to a 'higher for longer' environment, shedding earlier hopes of a relatively rapid retreat from current borrowing levels. The remarkable resilience of the US jobs market suggests they are probably right to do so.

For now, the optimism that drove the market rally over the first half of the year appears to have ebbed, a reflection perhaps that some investors bought too readily and too fully into the narrative

of peak interest rates, falling inflation and continued economic growth. Investors may have to wait a little longer than first hoped for the return of 'Goldilocks'. As such, some pullback in equity markets was probably to be expected. Nor would we be surprised if this more bearish tenor persists in the near term; we appear for now to be in a highly sentiment-driven market, with fundamentals secondary to myriad macroeconomic and geopolitical concerns. Recent bond market volatility and events in Israel have added to the litany of worries.

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A company's share price can often become unmoored from its underlying fundamentals during such periods. Extreme reactions to far-from-disastrous corporate updates are not uncommon. For the fundamental investor, this can be frustrating. Watching the share price of a market-leading business with excellent long-term growth prospects take a beating on short-term news flow is nobody's idea of fun. In our experience, however, such periods rarely endure. Fundamentals, the ultimate driver of share prices over the long term, cannot be ignored for long.

It's important then that we do not respond to market conditions by deviating from our investment approach. We cannot know how many of the issues buffeting markets at present will evolve, so far better to focus our analytical energies on the companies in our clients' portfolios than indulge in macroeconomic and geopolitical speculation. Amongst the noise, we must keep asking the simple question "Are these still the high-quality companies that will generate wealth for our clients on a sustainable long-term basis?"

From today's standpoint, we think we can answer that question in the affirmative with a good degree of confidence. This shouldn't be mistaken for complacency. The operating environment for many companies is undoubtedly tough, with some experiencing not insignificant cyclical headwinds. Prolonged inflationary pressures have taken a toll too, and along with higher interest rates have hit end demand in places. Overall, however, corporate updates and conversations with management teams have served to reassure us that our companies continue to operate in line with our long-term expectations.

That confidence extends to those companies that have been impacted by the rolling bad news story that is China. For now, an aversion to all things China appears to have become relatively entrenched in the market psyche, to the detriment of many of those companies with material exposure to the country. To some extent, this antipathy is understandable. Not only has the reopening of the economy failed to live up to expectations, but the debt-driven crisis in the country's real estate sector appears no closer to a resolution.

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In our view, however, sentiment has turned a little too negative on China's prospects. To fixate solely on the country's high-profile challenges is to ignore some of its very real strengths. We were reminded of this when two members of the Research team visited China in September. Conversations with management teams across five cities and a range of a sectors confirmed that the country's entrepreneurial vigour remains undimmed. There is a dynamism on display that has few matches anywhere in the world. The trip also provided some valuable context in the current environment, with several commentators suggesting that overseas reporting of China was prone to excessive pessimism. Hearing both sides of a story is never a bad thing.

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In time, we expect today's fear and loathing to give way to more measured assessment of China's prospects. We remain of the view that exposure to this market of 1.4 billion people will continue as a long-term tailwind for companies with high-quality, differentiated services and products.

Having climbed the wall of worry in the first half of the year, investors have since grown more circumspect, and perhaps with good reason. Exiting the era of unprecedented monetary largesse was always going to prove a bumpy ride, and without a playbook to consult, markets will likely prove skittish as we enter the home stretch of 2023. With this in mind, we reiterate the point made earlier: in time, investor attention will revert back to fundamentals. We make no prediction as to exactly when this will happen, but when it does we're confident that the merits of the companies in the portfolio will be recognised and rewarded.

## IMPORTANT INFORMATION

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## STOCK EXAMPLES

The information provided in this article relating to stock examples should not be considered a recommendation to buy or sell any particular security. Any examples discussed are given in the context of the theme being explored.

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