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[INTRODUCTION]
Staci West (SW): Welcome back to the 'Investing on the go' podcast brought to you by FundCalibre. We're focusing on the macro environment in Europe today and what risks it poses for investors. But we end on a high note with three well-known stock examples that should continue to perform well despite higher inflation.

James Yardley (JY): Hello, I'm James Yardley. Today we're going to be discussing European equities with Zehrid Osmani, the Elite Rated manager of the FTF Martin Currie European Unconstrained fund. Zehrid, thank you very much for being here today.

Zehrid Osmani (ZO): Thank you for inviting us, James.

[INTERVIEW]

JY: So, Zehrid, let's go straight into it then. So, what are your thoughts on Europe today? What is the environment? How is it for consumers and businesses at the moment?

ZO: So, there's many things to talk about in terms of the broader picture on Europe and the environment, starting with the macroeconomic environment.

There's clearly a big point of uncertainty around inflation and the elevated inflation that the whole world has been grasping with for the past 12 months. Our view on inflation is that it's going to stay elevated for longer, so somewhat stickier than what the market might be expecting. And therefore, that has implications in terms of monetary policy expectations. So, we think both the ECB [European Central Bank] and the Fed [Federal Reserve] will continue to keep a close eye on those abnormally high inflation pressures and could be continuing to hike for the time being.

And yes, there is a debate about getting closer to the end of the hiking cycle. We believe that that's not going to happen until 2024, but we're conscious that some market participants are of the view that there's going to be a pivot at some point this year. And that will in itself create an important bull/bear debate in the market, which was actually one of our points on the outlook for both Europe and the world for 2023, which is it's a year very high forecast risk and very elevated prediction error. And therefore, it's going to

create that volatility - we've already seen that year to date with very sharp moves - but there's going to be more coming, as we see inflation prints and as we see adjustments to monitory policy expectations.

Then when we look at the economic cycle, our view has been that we're heading into a sharp slowdown at the global level and at the US level, rather than a recession. And for Europe, we were of the view that Europe was already in an element of stagflation, partly related to the Russia / Ukraine conflict relating to higher prices of commodities, notably energy prices and the potential risk to activity.

What has changed since our outlook, and therefore to bring this up into your question on the environment, is China has suddenly reopened unexpectedly - and China being the second largest economy globally, it is important to keep an eye on the Chinese economic momentum as it's relevant to Europe. Well, Europe is more cyclically exposed to the global cycle, and notably to the China cycle, than any other developed market, and therefore, for Europe, it matters how rapidly China reopens.

What we're seeing in terms of the PMIs* for China is a very sharp recovery, both on the manufacturing and the services side. Our view on the Chinese reopening is that more of the momentum is going to come from services, and this could continue to have good momentum into the rest of the year which means travel, leisure, luxury goods, cosmetics companies will be positively exposed to that, and Europe is full of those type of companies.

[**the Purchasing Managers' Index (PMI) is an index of the prevailing direction of economic trends in the manufacturing and service sectors*

So, from that point of view, really what we're bringing into this is that the improvement in the Chinese economic momentum - which we estimate that it will drive 40 to 50% of the global GDP growth this year will be coming from China - will have a supportive effect for European economies and for the European activity. So as a result, we're somewhat more constructive about Europe generally when we are looking at developed markets. And that is supported also by valuations. If you look at valuations of developed market equities, yes, they have come down from the highest, both in the US and in Europe, but in the US, valuations are not as supportive as they are in Europe, compared to the long-term average, when you look on a cyclically-adjusted P/E** so, our view at the global level is Europe has supportive valuations, has to some extent an element of more supportive economic cycle because it's more cyclically exposed to China, and China is reopening, and in terms of companies that are exposed to the China cycle, there are a lot of good companies in the luxury goods - in the cosmetic space in particular - that could stand to benefit.

*[**cyclically-adjusted price-to-earnings is a ratio that is calculated by dividing a company's stock price by the average of the company's earnings for the last ten years, adjusted for inflation*]

JY: And you've previously mentioned 10 key risks you see for investing in the region. So, what are some of those risks and how might that impact the equity market? I mean, as we've seen already, we've had quite a lot of negativity in Europe with inflation, with the war in Ukraine, with concerns of the global

slowdown, and yet the European equity market has held up ok. Perhaps [due to] some of the reasons you were mentioning with the demand from China and things. So, what are these risks and how material are they?

ZO: Yeah, good question, James. So, the risks that we've listed are, to some extent, driven by policy expectations.

So, fiscal policies; the risk of fiscal policy slippages, notably, there's a sizable element of spending that is being planned, notably in terms of new energy sources, alternative energy sources for Europe, as they're driving to diversify away from Russian gas and Russian oil. So, that's an important element of potential risk if that plan doesn't follow through.

Monetary policy risk - so, we have to acknowledge that there is always the risk that central banks tighten too much and do create that recession. We talked earlier about how we put a probability of a recession to at 30 to 35%, so, we're still in a minority in terms of that scenario. That scenario could of course grow if monetary policies are overly hawkish, creating that more severe slowdown and into a recession.

There's then the risk around inflation, and that's our view; inflation will remain stickier, longer lasting, and higher, and therefore that creates in itself an important risk.

Those risks then feed into the risk of increased volatility, because when you have monetary policy uncertainty, you will have higher volatility in equity and bond markets, and within equity markets, you'll have higher volatility in terms of styles between quality growth versus value styles.

Then we also highlighted a few risks around impact on margins. So, higher inflation means potential risk to corporate margins, and therefore our focus on finding companies that have pricing power and are therefore able to protect themselves from that elevated inflation and protect their margins is critical. But that's an important risk at the corporate level.

The other risk at the corporate level is higher corporate tax rates, which the market isn't necessarily factoring in - our forecast when we're looking at companies and predicting companies' profits is to assume 300 basis points [3%] increase in corporate tax rates globally, because we believe at some point there will be a need to raise tax, given the elevated government debt levels that have come through since the Covid crisis.

And then there's a few additional risks to bring in to the frame, James. One of them is that geopolitical risk.And that geopolitical risk takes many forms. Clearly, in this area of Europe, it's a conflict, and the European territory with the Ukraine invasion by Russia. There is uncertainty there whether there's going to be conflict escalation or conflict broadening. So, that's an important focal point.

Broadly speaking, broader at the global level, there's China versus rest of the world, China versus Taiwan, China versus US, which is bringing an important geopolitical risk. And that one is a particularly important one for the market to focus on. Notably leading to another geopolitical risk, which is the technological fragmentation risk, where we are seeing in the semiconductor space in particular, that there's a race to bring in more independence in terms of semiconductor supplies or access to semiconductors by the various territories, notably the US, notably Europe.

And the final aspect is our view that in the long-term, growth will remain low and therefore will be impacted. So, the absence, or the low growth environment , means that we want to focus on companies that have structural growth exposure, so that can really generate their own weather, if you will, in terms of growth potential.

JY: And on that theme of structural growth, I mean, you've talked in the past about innovation and disruption, and you've identified eight thematic opportunities for the next decade. We've spoken about a few of these in the past; cybersecurity, green energy and healthcare. So, perhaps today you could tell us a bit more about some of the others; robotics and automation, the metaverse and quantum computing?

ZO: Yes, absolutely. So, robotics and automation and actually artificial intelligence is one that we bundle together. And that's an important one because our view is that as companies realise that post Covid, they need to make their supply chains more resilient and their production lines more robust, there is an increased propensity towards investing more into robotics and automation.

There's also the geopolitical angle that we just talked about, which fuels into the willingness by corporates to nearshore, onshore, or bring production lines to friendly-shoring elements of countries that are of less geopolitical risk. And therefore, again, that drive towards robotic and automation is going to be part of that element.

In addition to that, the artificial intelligence revolution that is taking shape as you can see and as you can read, is important, is critical to corporates in terms of driving their productivity, but also pushing for more creative momentum. And so the focus on investing more in the artificial intelligence is also an important area of investment opportunities.

So, for us, that theme in itself, robotics, automation, artificial intelligence, is a big driver. How we are able to gain exposure to that, ultimately, when you look at some of the drivers, it's related to semiconductor manufacturing microchips. And therefore, if you look at the European level, a company like ASML [Holding, N.V.], it's really well positioned from that point of view. It's also well positioned to take advantage of that geo-technological fragmentation that we talked about earlier. And hopefully we can talk about that in more detail in a moment. And then at the global level, it'd be companies like NVIDIA [Corporation] are also very well positioned in the artificial intelligence space.

And then the other one that you mentioned is indeed the metaverse and quantum computing. So, for us these two themes are somewhat nascent, but there's a lot of investment going into those two areas, notably in the metaverse - you can see some of the big tech companies spending a lot to try and get the metaverse right.

For us as investors therefore, a bit like in the robotics automation and artificial intelligence, we want to find companies that are enablers of that theme, or in other words, that are beneficiaries of the CapEx [capital expenditure] that these big tech companies are spending in the metaverse. And again, when you look at some of those drivers, they are related to the semiconductor space where you do need access to more microchips, faster microchips. Miniaturisation is another element which again, drives leading edge technology, which ASML is in a quasi-monopolistic space. So, there's opportunities that we see as very relevant, that drive an important area of CapEx cycle, that have a structural growth aspect, and where some companies in Europe are uniquely positioned to harness those opportunities.

JY: Yeah. So turning specifically to your portfolio then, I mean, it's a very concentrated approach. I mean, you've got almost a quarter of your fund invested in just three stocks, ASML, Ferrari [N.V.], and Moncler [S.p.A.]. So, what is it about these three companies that gives you such high conviction?

ZO: Yeah, you're right, James, to mention the concentrated aspects. So yes, we are high conviction investors, highly concentrated. At the moment we have 22 stocks in the portfolio, and as a result of being so concentrated, some of our top positions do constitute a large part of the portfolio.

So, when we look at ASML, Ferrari and Moncler, without going into too much detail at this stage, they have similar characteristics whereby when we look at companies, we want companies that operate in industries with high barriers to entry, that have dominant market positions or the potential to become dominant. It gives them strong pricing power, which to us is always an important factor, but even more so in a high inflation environment.

They are companies that have exposure to structural growth, so the element of generating their own weather in terms of growth potential. They also are companies that have high returns on invested capital. And for us, that's an important aspect. As investors, we are quality growth, and the quality element can be defined as high return on invested capital companies. They also have on the balance sheet side, strong balance sheets and compounding cash flows. And then on the ESG side, we look at companies with quality management, good corporate cultures and sustainable business models. And then the final criteria at the heart of all of this wheel, if you want to call it a wheel, is companies with attractive valuations based on our valuation methodology.

So, these three companies effectively emanate characteristics across all of this criteria that we've just listed. But when you go specifically on each of them; ASML is in a quasi-monopolistic position in that leading-edge, semiconductor technology. We believe that semiconductors are an important structural growth opportunity, even if the industry is cyclical. And ASML will benefit from that geopolitical fragmentation whereby you have semiconductor companies now building plants in the US, in Japan, and -

as of this morning - also an announcement of fabs being built in Europe, to avoid the over-reliance on the Taiwanese plant of TSMC, just to name one specifically, and therefore ASML will benefit from having to service more fabs, and send its tools to more factories effectively.

In the case of Ferrari - yes, back to your first question about the environment - the consumer environment is somewhat at risk of slowing down, given the risk of economic cycle slow down or potential recession, but our view with Ferrari is, it's favouring the high-end part of that consumption.

Ferrari has very strong pricing power - it's pricing its models at a 25 to 70% premium to its closest competitors, which are Aston Martin, Lamborghini, and Porsche. And that's because it can. It's got a long waiting list, which means that if we head into a recession, then they can tap into that waiting list to continue to keep their production lines at full capacity and therefore their margins high. And it has understood that strong pricing power, by actually producing periodically some limited-edition models, which actually end up being sold out before they even start production. So, if you have a period of slowdown in economic activity, they can move the production lines towards delivering, producing, sorry, and then delivering these limited editions. And actually their margin actually. So, a lot of reasons why Ferrari is really well positioned across both top line in terms of structural growth, but also in terms of ability to continue to drive strong returns on invested capital.

And in the case of Moncler … Moncler is in this segment of luxury goods, again, higher end consumption, where we're more positive than mass market consumption. It's a brand that's not overly exposed yet, so it's got a lot of greenfield opportunities to open more doors. But importantly has a CEO who's also the creative director, who's very focused on ensuring that the brand doesn't get overexposed, doesn't have too much inventory, which means doesn't run into a need to discount, which means pricing power is strong again. And then, from the point of view of newness, it's a phenomenally vibrant brand with very strong appeal in an age group that is very dynamic that also has a very good following across geographies, notably China. They ran a Moncler campaign on TikTok a couple of years ago, which generated 6 billion views which shows you that relevance. And then they've recently relaunched the Moncler Genius Initiative to drive more content and more appeal and more high profile. And they've got people like Farrell Williams, Alicia Keys, Jay-Z… being part of this campaigns, which again shows you how creative the brand is and how appealing it is to that age group that we mentioned earlier.

JY: Well, that's been very interesting Zehrid, thank you so much for joining us today and sharing your insights.

ZO: Thank you, James.

SW: The FTF Martin Currie European Unconstrained fund is a high conviction, no constraints portfolio of quality growth companies. It has a long-term approach focusing on a 5-to-10-year time horizon. To learn more about the FTF Martin Currie European Unconstrained fund visit fundcalibre.com – and don't forget to subscribe to the Investing on the go podcast, available wherever you get your podcasts.