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FUND COMMENTARY

THREADNEEDLE GLOBAL EQUITY INCOME FUND (Unhedged)

Summary

- Global equity markets gained in October.
- The fund underperformed its index in October following a strong September.
- New positions were initiated in Telekomunikasi Indonesia, Thai Beverage, Erste Bank and Anglo American.

Market Background

The MSCI AC World Index, which rose 2.6% in local-currency terms, hit new record highs in October, as did the S&P 500. Optimism over President Trump's ability to stimulate growth and push tax reform drove the rally, although this faded slightly towards month-end as the first indictments were served in the investigation over Russian influence in last year's elections. Investors also welcomed some better-than-expected economic indicators – notably third-quarter GDP growth – and upbeat earnings news.

Europe ex-UK equities advanced in October as investors cheered generally buoyant corporate results and economic indicators. The European Central Bank finally announced much-awaited cuts to its stimulus programme: the central bank will drop monthly purchases from €60 billion to €30 billion from January, and will keep that measure in place until at least next September. Japanese equities had a buoyant month, with investors cheered by the decisive victory of the prime minister's party in the snap general election. Emerging markets outperformed developed markets, with China's A shares leading the rally. At the Chinese Communist Party's five-year congress, a constitutional change elevated President Xi's power. Notably, changes to the Politburo suggested no likely successor.

Performance

Net of fees, the fund underperformed its index in October following a strong September. Income as a style struggled and accounted for the majority of the underperformance experienced, with the MSCI ACWI High Dividend Index underperforming the broader MSCI ACWI by 130 basis points. The technology sector also reached new heights this month, amid positive earnings reports; the fund's structural underweight to the sector therefore hurt relative performance.

From a stock selection perspective, the fund's holdings in industrials and utilities detracted – most notably General Electric and PG&E in these respective sectors – while rate-sensitive financials pulled back slightly following strong runs through September. General Electric's decline was largely due to concerns over the company's earnings report, while PG&E fell on rumours of liability in an investigation in the US – though the stock stabilised later in the month.

More positively, General Motors and GVC Holdings contributed to a strong month for the fund's consumer discretionary holdings, while Taiwan Semiconductor, Maxim Integrated Products and Tokyo Electron all rewarded the its exposure to semiconductors, a sector which continues to receive attention from investors as rising demand for chips persists across multiple industries. General Motors' rise

came amid news of a pledge to launch 20 all-electric cars by 2023, while GVC Holdings moved higher on strong results, rising implied market share and positivity surrounding its ability to complete value-adding M&A.

Activity

During the month, the fund initiated positions in Telekomunikasi Indonesia, Thai Beverage, Erste Bank and Anglo American. Telekomunikasi Indonesia benefits from a dominant position and a growing share in an attractively structured market. There are strong indications the company can sustain its competitive advantage as competition from new entrants fades, given the firm's recent spectrum auction success. This means the company can therefore become a long-term winner and recent share price weakness presented an opportune moment to start a position. Thai Beverage maintains a strong market position within the spirits segment, coupled with the potential to regain share in the beer market while boosting margins. Evidence suggests these factors are currently underappreciated by the market. For Erste Bank, whose funding structure and capital position have been improving, returns can climb on loan growth, gradually increasing net interest margins, and a reasonably benign cost of risk outlook. This should be helped further by a constructive Central and Eastern European macroeconomic environment, with Erste offering good interest rate optimality. Finally, global mining firm Anglo American's balance sheet has improved of late, and its platinum business appears to be strengthening. The company is attractively valued relative to other miners and offers a preferable medium-to-long term outlook.

Reallocating capital towards positions with a stronger upside, the fund topped up Daiwa Securities and Unilever. For the latter, a high-conviction position, the recent pullback in share prices presented a good opportunity to increase the fund's holdings. The fund also closed its position in DowDuPont following a strong run.

Outlook

Although doubts persist about Trump's ability to push through market-friendly reforms, the Fed's plans to continue with interest-rate rises suggest that prospects for the US economy remain broadly positive. Improving economic data from Europe continues to provide grounds for optimism. While any tightening of monetary policy in the eurozone and the UK might indicate a welcome move back towards "normality", it could generate headwinds for the global economy in the near term.

Against this backdrop, the fund manager continues to focus on "quality income", seeking competitively advantaged companies that generate strong cashflows and offer high dividend yields, as well as growing and sustainable dividend streams. In the fund manager's view, a strategy that emphasises both income and growth characteristics should remain attractive to long-term investors. Despite headwinds which can generate shorter-term challenges, the fund looks well-positioned to outperform in the coming years. The fund manager also retains his conviction in the ability of high dividend paying stocks to outperform over these longer time periods.

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