FUNDCOMMENTARY – Q1 2025
CT PAN EUROPEAN FOCUS FUND

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Summary

- European equity markets gained over the quarter.
- The fund underperformed its benchmark index on a gross basis.[1]
- Key relative contributors included Rolls-Royce and Munich Re.
- Detractors included ASM International and Prysmian.

Market Background

European equity markets gained in the first quarter (Q1) of 2025; the fund's benchmark index rose by 6.1% in euro terms and by 7.3% in sterling.

The start of 2025 saw a strong rally in European equity markets, buoyed by progress on the inflation front, expectations of further monetary easing and generally resilient corporate results. President Trump was inaugurated in mid-January, and markets initially climbed on hopes that his promised tax reductions and loosening of regulations would be economically supportive. Markets initially hoped that his threats to hit US trading partners with fresh import tariffs were more of a negotiating tactic than a long-term strategy; in the event, however, the size and extent of the tariffs imposed caused a sharp increase in global equity market volatility, boosting demand for safe havens and value stocks.

In Q1, Trump placed tariffs on Mexico, Canada and China, and on all steel and aluminium imports; he also warned that levies on other major trading partners would follow. After the date of this report, Trump announced an extensive list of additional tariffs on 2 April, and China retaliated with its own tariff on imports from the US. The size and range of these tariffs caused some stock market disruption investors assessed the potential repercussions on inflation and economic growth. A week later, Trump paused the implementation of higher tariffs for 90 days to allow a period of negotiation; this spurred a relief rally in equity markets. High tariffs remained in place for China, as well as a 10% levy on other countries and a 25% levy on steel and aluminium imports to the US.

Geopolitics also remained in focus. Optimism that Trump may broker a Russia-Ukraine ceasefire faded in the near term following a heated exchange with his Ukrainian counterpart in February, and fraught negotiations thereafter regarding a ceasefire and a potential minerals deal.

The European Central Bank (ECB) cut its key interest rate by 25 basis points (bps) in January and again in March. Consumer price inflation (CPI) in the eurozone remained near the central bank's target of 2%, leaving room for further interest-rate reductions. The region's composite purchasing managers' index (PMI) edged into expansionary territory in January, led by the services sector; the corresponding PMI of manufacturing output followed suit in March, according to a flash report, following a lengthy period of contraction.

German federal election results largely matched forecasts, with the conservative CDU/CSU taking the largest share of the vote. Parties subsequently agreed to create a €500 billion infrastructure fund and, amid fears about the withdrawal of US military support, to allow greater investment in defence by amending the country's constitutional 'debt brake'. Separately, EU leaders pledged to embark on a substantial defence-spending package and to boost military aid to Kyiv. This heightened concerns about the increasing fiscal burden but prompted a rally in defence, and European construction stocks.

The Bank of England (BoE) cut its key interest rate by 25 bps in February, but its Governor reiterated that future rate cuts will likely remain gradual. The BoE also downgraded its economic growth outlook for 2025, although the flash composite PMI in March provided grounds for optimism. Late in the quarter, the UK Chancellor announced plans for a range of spending cuts and other measures to abide by the government's narrow fiscal headroom, as well as a significant increase in defence spending.

The technology sector was especially volatile in Q1. Tech stocks and some industrials sold off when Chinese company DeepSeek launched a new opensource AI model. The relatively small processing power required by the new app called into question the large capital spending programmes of US counterparts and raised questions over the possible impact on the wider value chain. It is yet to be determined whether this new model is replicable by other labs, although it is possible that DeepSeek's innovation could speed up the wider adoption of AI.

Spain, Norway and Italy led the benchmark's gains in Q1; the main laggards were Denmark, the Netherlands and Portugal. On a sector basis, financials performed strongly as investors surmised that interest rates may remain higher for longer given the inflationary impact of tariffs. Energy and communication services also performed well. Technology was the weakest sector, followed by consumer discretionary and real estate, as concerns mounted regarding increased competition in AI and the economic outlook as tariffs take effect.

Performance

On a gross basis, the fund underperformed its benchmark index over the quarter.[1] Stock section was unfavourable, as was country positioning, especially the overweighting in the Netherlands. Sector allocation was beneficial, boosted by the underweighting in healthcare and the overweighting in industrials.

Top relative performers included Rolls-Royce and Munich Re. Rolls-Royce released robust annual results, with operating margin expansion in civil aerospace, defence and power systems. The firm raised its medium-term financial targets as Europe focuses on rearmament, and announced a share buy-back programme. Munich Re outperformed amid strength in the financial sector. The reinsurance firm announced impressive annual results and issued upbeat financial forecasts. The concentrated reinsurance market has been a beneficiary of capacity tightening, and Munich Re has good management and a strong balance sheet.

Detractors included ASM International and Publicis. After a strong start to the year, shares in ASM International fell following the DeepSeek news and on tariff concerns. The firm also published soft order numbers, noting weakness from China. We remain confident in the business model. ASM International manufactures equipment used to produce semiconductors and is a global leader in advanced deposition technology. The firm remains a direct beneficiary of the growing demand for AI. Publicis is a leading advertising agency with brand strength, efficient scale and an excellent client book. Results for 2024 were strong; the firm has successfully harnessed AI to drive its business forward. The cost reduction since Covid has boosted margins and the Epsilon and Sapient acquisitions are generating synergies. A slight softening of growth is expected in 2025; there are some concerns that consumer-goods companies may reduce their advertising expenditure. Two major rivals (Interpublic and Omnicom) have announced plans to merge, stiffening the competition, although Publicis continues to make acquisitions of its own.

Activity

New holdings included Deutsche Telekom, UBS and Hermès. Deutsche Telekom is a high-quality telecoms operator. As well as domestic EU exposure, particularly in Germany, the firm has attractive exposure to the US (T-Mobile). UBS has a strong wealth management franchise, and the Swiss bank is generating synergies from the Credit Suisse acquisition. Hermès is a high-quality luxury goods business, with exceptional brand strength. Margins are continuing to grow, and results have been strong. The firm has long waiting lists for key products and is less exposed to any economic sensitivity that may affect other luxury companies.

We sold Novo Nordisk and VAT Group. Novo Nordisk is facing increasing competition in the weight-loss market and also released disappointing results for its next-generation obesity drug in recent trials. Tariffs are another issue as Novo Nordisk has a high level of exports to the US. VAT Group reported soft results, and we prefer other semiconductor stocks.

Outlook

Markets have been dominated by concerns over inflation and interest rates after the long period of low inflation and rates. Covid restrictions reduced, demand picked up, the war in Ukraine intensified and inflation rose. Tighter monetary policy is taking effect and inflation is now lower. The new US President is committed to a solution to the war in Ukraine. Negotiations have been fraught, and current discussions are around US support for Kyiv being replaced by European support, entailing major rearmament.

Germany is amending the debt brake on infrastructure and defence. This could potentially encourage other European governments to increase capital expenditure.

In the US, the Republican majority in Congress, combined with use of Presidential decrees, is enabling Trump to push through policies on immigration, taxation, energy prices, trade tariffs and global conflict. All of these have an element of unpredictability as Trump deal-makes to cement his legacy.

It has been widely documented that the outlook for the European economy looks tough. Despite this, there are some green shoots emerging. Europe trades on a substantial discount to the US and the risk premium in Europe is far more attractive too.

Europe is not only attractive on valuation grounds. Inflation has proved to be less sticky and, as a result, there is now wider dispersion in rate cut expectations in Europe versus the US. Falling interest rates stand to benefit the longer-term, high-quality business models we own. The European consumer is in a stronger position too, with more excess savings than US counterparts. The first half of 2025 may show slow growth, but the second half should be better. Trump's proposed tariffs have caused some short-term turmoil in markets, but they have brought a lower oil price which reduces costs and inflationary pressures in Europe – supporting the case for lower interest rates both in absolute terms, and relative to the US.

Despite the softness in the European economy, many of the businesses we own are global leaders, generating profits worldwide. As such, they are typically less exposed to the domestic European economy. Longer term, the NextGenerationEU plan, the use of AI to boost productivity, and increased capital expenditure may reinvigorate European growth. Banks and European corporates generally have strong balance sheets, which supports capital expenditure and renewed lending.

As always, there are risks – notably geopolitical tensions, tariffs, weakness in China, a weak economic outlook and a fragmented European marketplace – but there are a number of reasons to invest in Europe.

In European equities, there are reasons to remain optimistic. Earnings have been resilient despite higher interest rates and, over the longer term, share prices tend to follow earnings. Good companies continue to grow, and we see opportunities in the current market. In managing this fund, our focus is on stock selection, informed by macro-economic and thematic views. We favour high-quality companies with the pricing power to sustain strong returns, and we also target re-rating opportunities.

[1] Past performance does not predict future returns. Please refer to the KIID document found on our website for further information on the fund performance.

Key Risks

The value of investments can fall as well as rise and investors might not get back the sum originally invested.

Where investments are in assets that are denominated in multiple currencies, or currencies other than your own, changes in exchange rates may affect the value of the investments.

The fund has a concentrated portfolio (holds a limited number of investments and/or has a restricted investment universe) and if one or more of these investments declines or is otherwise affected, it may have a pronounced effect on the fund's value.

The fund may invest in derivatives (complex instruments linked to the rise and fall of the value of other assets) with the aim of reducing risk or minimising the cost of transactions. Such derivative transactions may benefit or negatively affect the performance of the fund. The Manager does not intend that such use of derivatives will affect the overall risk profile of the fund.

The fund typically carries a risk of high volatility due to its portfolio composition or the portfolio management techniques used. This means that the fund's value is likely to fall and rise more frequently and this could be more pronounced than with other funds.

The risks currently identified as applying to the fund are set out in the "Risk Factors" section of the prospectus.