Digital Economy strategy

Corporate earnings results for the strategy have been so far favourable

- Global equity markets retreated during October with increased market volatility
- Weakness from logistics companies with limited visibility on improving trends
- We reviewed our Chinese exposure and repositioned our gaming holdings

Pauline Llandric, Tom Riley
co-Portfolio Manager, Digital Economy Strategy

What's happening?

Global equity markets retreated during October, with the MSCI ACWI declining 2.2%[1]. Market volatility increased as investors positioned themselves ahead of the US presidential election and digested robust economic data which led to reduced expectations for aggressive Federal Reserve rate cuts.

Third quarter earnings season is underway and for those companies in the MSCI ACWI Index that have reported their first-quarter numbers, 52% have reported better-than-expected earnings. For the strategy's investments, this compares favourably with 86% reporting better-than-expected earnings[2].

Portfolio positioning and performance

The strategy posted slightly negative performance but outperformed the broader equity market during the month.

Our investments in the 'Decision' sub-theme provided the strongest contribution over the month. Online travel platform Booking Holdings led the gains with strong quarterly results and raised guidance, citing robust global travel demand (in particular in Europe) and successful Artificial Intelligence initiatives. UK-listed digital rail platform Trainline performed well following strong first half results and raised guidance for its fiscal year. Streaming entertainment company Netflix also added to positive performance after reporting strong subscriber growth, with ad-supported tiers now accounting for over half of new sign-ups in available markets. This strong performance was partially offset by Chinese gaming and ecommerce companies Netease and Alibaba, giving back some of the strong gains from the previous month.

[1] Source: Bloomberg in USD as of 31/10/2024
[2] Source: Bloomberg as of 01/11/2024

Within Discovery, Alphabet drove positive contribution following better than expected quarterly results in its search and cloud services businesses. The company highlighted strong user engagement with AI-powered search features, including AI Overview reaching one billion monthly users, and reported that users are asking longer and more complex questions, leading to increased search usage overall.

The Data & Enablers subtheme saw mixed performance. Enterprise cloud software provider Salesforce gained on growing optimism around its Artificial Intelligence monetisation strategy. Human Capital software provider Paylocity reported better than expected results, benefitting from improved sales execution in upmarket. This positive contribution was offset by Enterprise software and cloud computing platform provider Microsoft. Despite maintaining strong margin control and seeing growing adoption of its Artificial Intelligence solutions like Microsoft 365 Copilot, its Azure cloud business faced capacity constraints that impacted growth guidance. Global IT consulting and digital transformation services firm Capgemini was weaker over the period as it continues to face a challenging environment, lowering guidance due to manufacturing sector weakness.

The Delivery subtheme was the biggest detractor to performance this month. We saw good performance from payment network company Visa who delivered solid results and highlighted strong momentum in digital payments globally, particularly in e-commerce transactions and new digital flows like account-to-account payments. We also saw strength from our cybersecurity names as CIO surveys continue to point to cybersecurity as a top spending priority. However, this positive contribution was offset by logistics companies Prologis and Goodman Group. Despite Prologis reporting quarterly results ahead of expectations, visibility on improving trends remains limited.

During October, we reviewed our Chinese exposure and repositioned our gaming holdings. Within China, we exited Chinese e-commerce platform Alibaba and online gaming and entertainment company NetEase and purchased online food delivery, local services and travel platform Meituan. Alibaba continues to face intense competition while Netease has recently cancelled some underperforming games. In contrast, Meituan's food delivery and travel segments should be well-positioned to benefit from recently announced government stimulus measures including food and hospitality vouchers. Within gaming, we sold entertainment and technology conglomerate Sony Group and reallocated the proceeds to increase our position in gaming company Nintendo. Whilst Sony's music segment remains strong, we see limited near-term catalysts as its new high-end gaming console may have limited appeal beyond core gamers. Nintendo offers a more focused investment case and is approaching a potential new console cycle in its next fiscal year.

Outlook

The Digital Economy continues to evolve and expand, powered by fast technological advancements, shifts in consumer behaviour and the persistent digital transformation efforts undertaken by businesses across sectors. Despite the rapid growth and adoption of digital technologies in recent years, we firmly believe that there remain substantial opportunities for companies to innovate, create value and drive further progress.

We see significant potential in companies that leverage digital technologies and innovative business models to deliver compelling value propositions to their customers, disrupt traditional industries and capture market share. This encompasses businesses that are at the forefront of innovation in areas such as e-commerce, cloud computing, cybersecurity and other crucial aspects of the Digital Economy.

We maintain our conviction that the fund is well positioned to benefit from the secular trend of Artificial Intelligence (AI). As businesses increasingly recognise the transformative potential of AI and the critical importance of data across the Digital Economy value chain, we anticipate the fund to capitalise on the development of AI-powered applications in the coming years. Data lies at the core of digital transformation and businesses that effectively leverage their data are poised to gain a significant competitive edge. The emergence of Generative AI has only heightened the urgency for companies to embrace change or risk being left behind.

The market has been experiencing a narrowing concentration since early 2023, with mega-companies driving a significant portion of the gains. This trend reached its peak in July 2024, marking the narrowest market in over 15 years. However, since then, we have observed a modest broadening of market participation, suggesting that the anticipated shift towards a new interest rate cycle is starting to gain traction. This emerging trend could indicate the potential for a more favourable environment for equities across the market capitalisation spectrum. By focusing on key trends and maintaining a disciplined investment approach that targets well-positioned companies within our themes, we aim to capitalise on the ongoing evolution of the Digital Economy across a wide range of market segments and under various market conditions.

Looking ahead, we remain optimistic about the long-term growth prospects of the Digital Economy and the opportunities it presents for investors. As we navigate the ever-changing landscape, we will continue to identify and invest in companies that we believe are best positioned to thrive in this dynamic environment. Our commitment to our investment philosophy and process, combined with our understanding of the Digital Economy, positions us well to navigate the challenges and opportunities that lie ahead.

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