Sparinvest

WAR CAUSES MARKET DECLINES

Oil spikes as critical Strait of Hormuz is closed

On the last day of February, the United States and Israel began to attack Iran. It quickly became clear that the scope of the attacks were far beyond the attacks of last July, and although the aims of the war were not clearly articulated, the early weeks of the war saw the senior Iranian leadership killed in airstrikes and significant damage to Iranian air, naval and missile launching capabilities. In retaliation Iran launched missile and drone strikes against targets across the Gulf and effectively closed the Strait of Hormuz. The closing of the Strait, a critical transit point for over 20% of global seaborne crude oil, led to an immediate jump in the oil price to over $100 a barrel, fueling inflation fears globally as well as jeopardizing economic growth in Asian and European economies.

The MSCI World index declined by 4.05% in March after the initiation of the war. European and Asian markets were the hardest hit, as their economies are most dependent on imported fossil fuels, whereas the US, which is a net oil exporter, saw more modest market declines. The MSCI Europe index fell by 7.68%, compared to a decline of 2.58% for the MSCI USA. Within Europe, German and French equities were amongst the larger decliners, with markets such as the UK benefitting from having significant exposure to oil and gas companies.

The rise in the price of energy had an immediate effect on inflation expectations globally. US interest rates rose across both short term and longer term maturities. German yields also rose, however the rise was more marked at the shorter end of the curve, as longer term there are fears over the impact of the oil price shock of GDP growth.

Oil and gas prices spiked dramatically during the month as Iran closed the Strait of Hormuz to shipping, as well as hitting key natural gas fields in the region with missiles and drones. Aluminum prices also rose as aluminum smelters in the Gulf region were also impacted by the war.

Value style a modest positive in broad sell-off

The portfolio declined by 4.49% in the month, underperforming the 4.05% decline in the MSCI World. The lack of exposure to fossil fuel producers in the fund due to the fund's exclusions was a major contributor to the underperformance. The energy sector was a strong performer in the month due to the rise in commodity prices. The value style was a modest positive contributor to performance in the month, and the fund also generated some positive stock selection. The MSCI World Value declined by 3.79%, a slightly smaller decline than the MSCI World, reflecting the strength of the value style. Relative to the MSCI World Value, the lack of exposure to the energy sector had an even more significant drag on performance, as energy is a larger weight in the value index than in the broad market index.

Energy was the only positive market sector in the month, with all other sectors experiencing declines. Utilities and Information Technology had the smallest declines among the other sectors. The biggest declines amongst global sectors were in the cyclically biased sectors of Industrials and Materials. The normally defensive Consumer Staples sector was also weak due to fears over rising cost inflation in the sector combined with a weak demand environment.

Despite the market declines, the fund had a number of stocks that performed well, contributing to positive stock selection in the month. US enterprise server company Hewlett Packard Enterprise rose after the release of Google's TurboQuant AI algorithm that potentially reduces the need for memory, a key cost element in HP's AI servers. Japanese insurance company Tokio Marine also performed well in the month after it was announced that Berkshire Hathaway was taking a strategic position in the company stock and would collaborate with the company on M&A opportunities. Alcoa, the US aluminum producer, also had a strong month as the company benefits from the rising price of aluminum in global markets.

Strategy

Ethical Global Value invests in global equities from developed markets, cf. the fund's prospectus. Stocks are selected using the value strategy, meaning that through careful fundamental analysis, the team strives to identify companies that trade at healthy discounts relative to intrinsic value. A riskaware approach to the portfolio construction ensures a well-diversified portfolio and broad exposure across sectors and regions. Ethix SRI Adviors performs an unbiased screening to ensure that only ethically sound companies are included in the portfolio.