

Capital Group Global Equity Fund (AU)

Market review

Global stocks fell sharply as rising inflation, higher interest rates and the war in Ukraine combined to push the U.S., Europe and Japan into bear market territory. Slowing global economic growth and fears of a potential recession further weighed on markets, accelerating a broad selloff that commenced shortly after the start of the year.

U.S. equities fell into their first bear market since 2020 as persistently high inflation and rising interest rates headlined investor concerns. Inflation hit another 40-year high as the Consumer Price Index for all items climbed 8.6% in May from the previous year. The increase was broad-based, with shelter, gasoline and food the largest contributors. Energy costs soared 35% and grocery prices climbed 12% year over year. Consumer confidence in June fell to a nine-year low. The Federal Reserve hiked its policy rate more aggressively than originally expected at its June meeting, partially in response to the May inflation report.

European stocks declined amid the ongoing war in Ukraine, record-high inflation and firm indications from the European Central Bank (ECB) that it will begin raising interest rates in July. Despite fears of a war-induced recession, ECB officials said rates must move higher as consumer prices soared across the eurozone. ECB president Christine Lagarde, emphasizing that inflation is "broadening and intensifying," left little doubt that the central bank will increase its key policy rate at the governing council's July 21 meeting. It would be the first time the ECB has done so since 2011.

Japan equities fell, weighed down by slowing global growth, a weak yen and ongoing supply chain problems. The yen hit a 24-year low against the dollar in mid-June. The currency continued its descent after the Bank of Japan maintained its ultra-loose monetary policy. Japan's industrial output fell the most in two years in May as a semiconductor shortage and China's coronavirus lockdowns disrupted supply chains. However, optimism grew as Japan lifted some COVID-19 restrictions for tourists.

Portfolio review

Over the quarter, Capital Group Global Equity Fund (AU) returned -8.3%¹ before fees, while the index returned -8.4%². Net of fees, the fund returned -8.6%³. Over a one-year period, the portfolio returned -11.4%¹ before fees, and -12.2%³ after fees, compared with the index's return of -6.5%².

Sector attribution for Q2 2022

- Investment choices in the consumer discretionary and financials sectors lifted relative results.
- In contrast, an above-index exposure to the information technology sector detracted from relative returns, although it was partly offset by relative gains from our choice of investments. Both stock selection and an above-index exposure to the materials sector weighed on relative returns.

Contributors and detractors for Q2 2022

- Consumer discretionary: Not holding Tesla helped as its shares slid 38% against a deteriorating economic outlook, with worries on the potential for demand to slow, especially as the electric vehicle company continued to raise prices for its models in response to increasing input costs, pressuring affordability for its customers.
- Financials: Insurer **AIA Group**'s shares gained 5% on easing coronavirus restrictions. In April, the company said its businesses were regaining momentum in areas where coronavirus infections had peaked.
- Information technology: Shares of Dutch semiconductor equipment maker **ASML** lost 25% during the quarter following worries over a potential slowdown in demand for the semiconductor industry alongside continuing supply chain constraints and cost pressures.
- Materials: Brazilian miner **Vale** saw its shares fall 20% during the quarter. Industrial metals prices fell given waning Chinese demand and rising concerns over the risk of a global recession amid central banks' aggressive response to elevated inflation.

Outlook and strategy

Inflation is elevated and pricing pressures have broadened, keeping the US Federal Reserve on its course of interest rate hikes. Supply chain disruptions and rising costs have eroded corporate profit growth. Geopolitical pressures such as the war in Ukraine and COVID lockdowns in China magnify these risks.

All of this adds up to an American economy firmly in late-cycle territory. Late cycles are not predictive of recessions, but they do signal that the economy's ability to bounce back from shocks is reduced. However, areas of strength can still be found across the American economy. These include healthy corporate balance sheets and growing industrial production. Our US economist expects the next US recession to be a healthy correction that addresses imbalances, not the kind of wipeout investors endured in 2008.

Elsewhere, the European economy is holding up remarkably well despite investor worries about a war-induced recession. In particular, the services sector has done much better, driven primarily by pent-up demand. The services sector - which includes finance, retail and tourism among others - accounts for the bulk of employment and economic output in the eurozone. Our Europe economist expects GDP growth in the eurozone to come in around 2.5% to 3.0% this year. That would represent a strong expansion relative to the eurozone's average GDP growth rate of roughly 1.0% over the past decade.

Against this backdrop, portfolio managers remain committed to finding companies with high growth potential, strong barriers to entry and sustainable pricing power. They are further interested in companies that are better positioned to benefit from the next wave of digital disruption and believe current market conditions are well suited to bottom-up security selection grounded in deep, fundamental research.

Index returns are shown in US dollar terms while stock returns are total returns as shown in local currency terms, unless otherwise stated. Sources: Capital Group, MSCI

¹ Returns are before management fees and expenses, in Australian dollar terms. Source: Capital Group

² MSCI World ex Australia Index with net dividends reinvested, in Australian dollar terms. Source: MSCI

³ Returns are net of fees at maximum management fee, in Australian dollar terms. Source: Capital Group

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