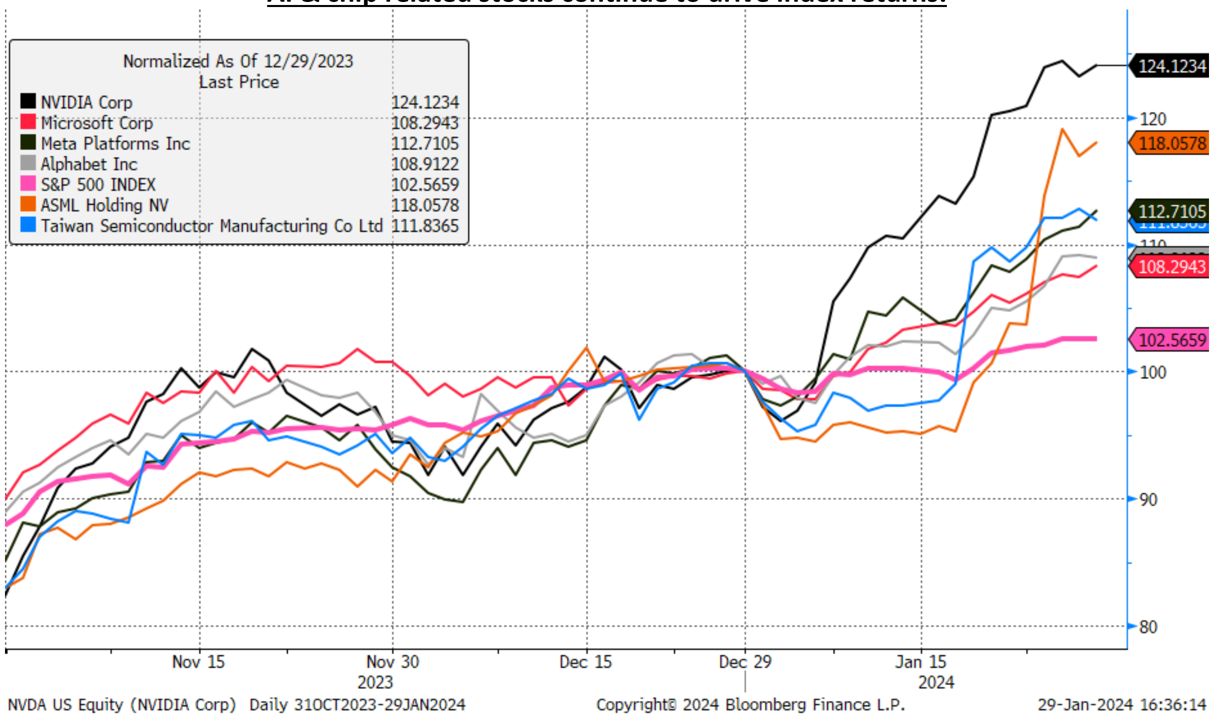
"It is always the simple that produces the marvellous" – Amelia Barr

After a muted start to the new year, the market rebounded in a robust manner with the AI related companies pulling the wider indices up over the month. TSMC's comments on how AI demand would generate a multiple year tailwind for the chip industry led to the belief that the inflection in the chip cycle is upon us, adding further fuel to the fire.

<u>AI & chip related stocks continue to drive index returns.</u>



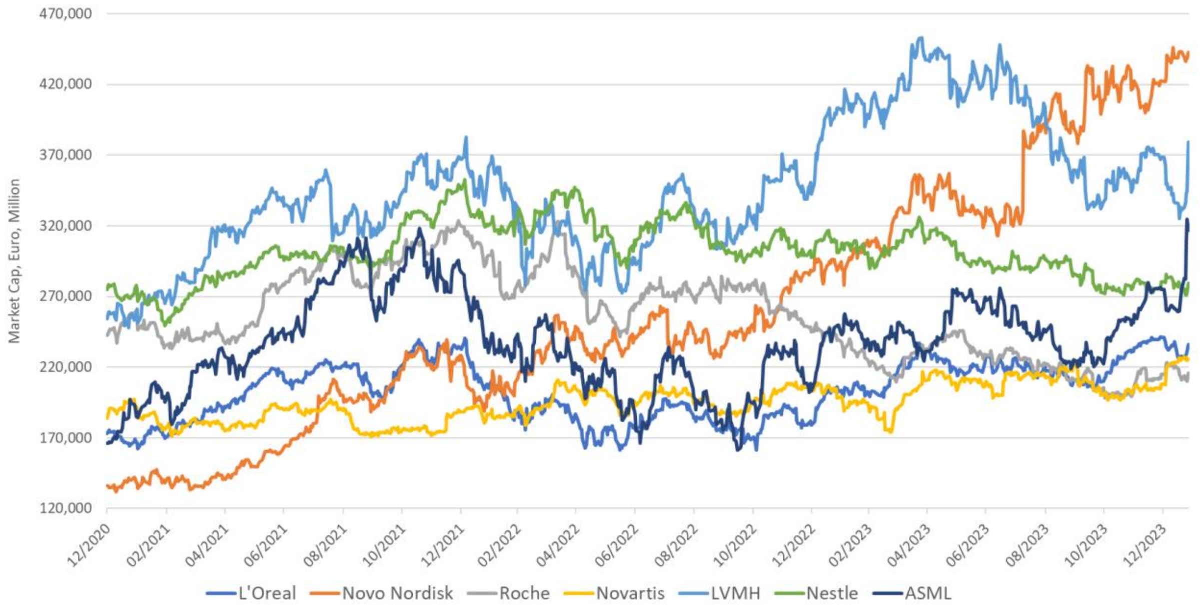
Normalised to 31/12/23, Source: Bloomberg

The dominance of the technology stocks is more apparent in the United States given the difference in sectors weightings. The Information Technology sector accounts for 29.8% of the S&P 500, with the market capitalization of Apple, Microsoft and Alphabet being greater than that of the FTSE 100, Swiss Market Index and Eurostoxx 50 combined. Conversely in Europe, Information Technology accounts for 7.8% of the Stoxx 600 index, behind that of Financials, Industrials, Health Care, and both Consumer Staples and Discretionary.

With a much more diverse composition, the largest companies in the European index are much more varied than that of the S&P, with no company accounting for more than 3.2% of the index, and the top 10 accounting for 21.3% of the whole. Meanwhile in the US, Apple has a weighting of over 7%, and the top 10 account for 30.8%. Unfortunately for global investors the MSCI world index is little better as the top 10 companies are all listed in the United States (and therefore very similar to the S&P 500 top 10) and account for 20.5% of the whole, giving Information Technology a weighting of 23%.

The concentration and overlap of the major indices should concern investors who prefer to invest in passive funds. Despite the inherit problem of by design underperforming the index they are designed to track, investors can also be hostage to momentum both on the way up, and the way down, and are not getting the diversity that they may think by investing in a large basket of stocks; as active managers we believe in constructing funds with high active share, and giving investors exposure to only the best companies in the world. Furthermore, this fund has a self-imposed maximum position size of 5% to reduce too much single stock factor risk, we worry in the dangers for investors in a world where passives now account for a greater percentage of all equities invested than those in active funds.

Europe is more varied in the sectors of its largest companies, and the top 5 are changing.



Source: TIM/Bloomberg

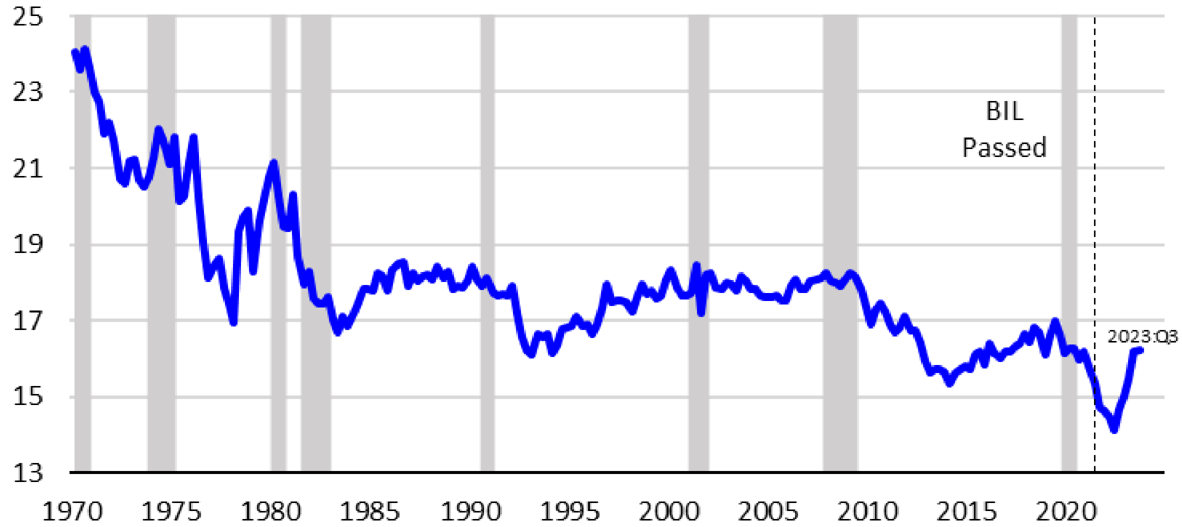
The recent macroeconomic data has been mixed with Purchasing Managers' index readings for Europe showing further contraction and GDP ranging from 2% growth in Spain to -0.3% in Germany. Despite all the negativity towards the UK, their PMI surveys continue to indicate improving growth in services and whilst still some malaise in manufacturing. The outlier is the US, where the balance of economic data continues to be positive as the Citi economic surprise index below shows.

The US continues to bring in the good news.

Source: Bloomberg

With companies talking about investments from re/nearshoring, the CHIP and Science Act, The Inflation Reduction Act (IRA), the Bipartisan Infrastructure Bill (BIL) and the European Green Deal all starting to feed through to their order books, we believe that the outlook for companies is not as bleak as the economic data might suggest. We have concerns, however, as to the scale of stimulus that might be needed in China to restart the juggernaut, as lack of confidence in the housing sector is feeding through to consumer sentiment in the region.

Is 40 years of underinvestment, as a share of GDP, by state & local bodies about to change?



Source: Bureau of Economic Analysis; U.S. Treasury calculations.
Notes: Capital investment is gross investment in equipment and structures. Shading denotes NBER recessions.

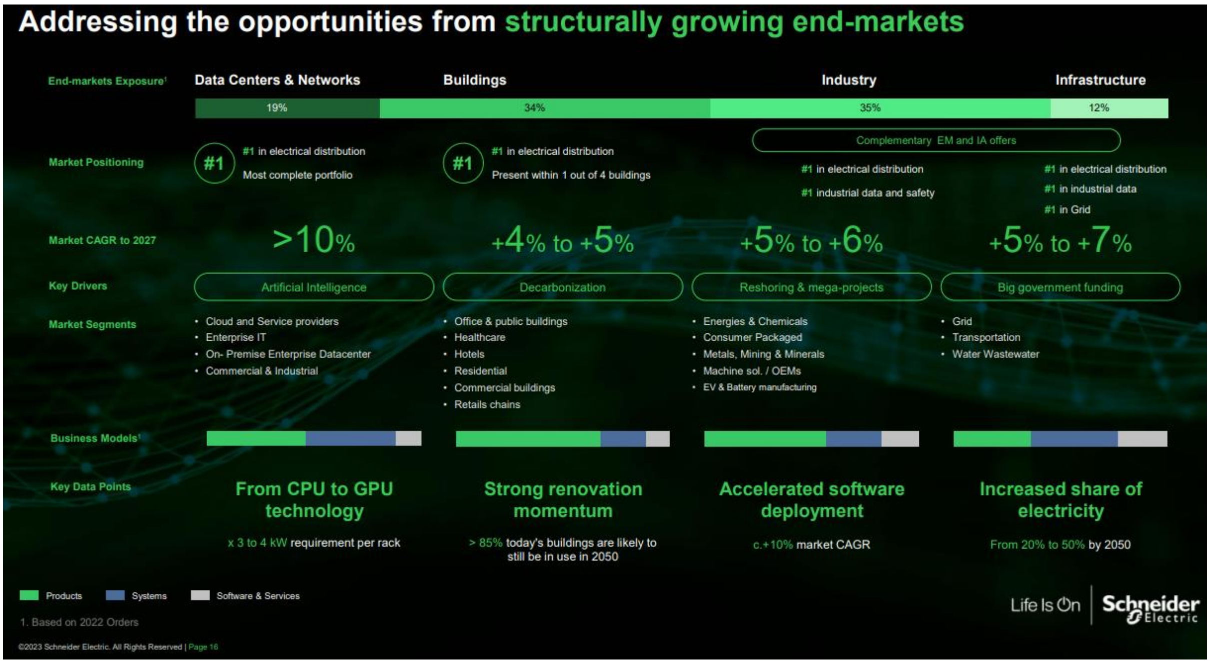
Geopolitically, Taiwan's elections passed off without any significant reaction from China, and attentions appear to be more focused on the possibility of Donald Trump returning to the White House as he swept to victory in the first two Republican primaries, and all but one of his challengers have pulled out of the running. In what is a bumper year for elections, a record of 64 in total, including India and the UK, the US Presidential undoubtably takes centre stage. Although elections can cause volatility, especially in technology and healthcare stocks, which are seen as easy targets to score political points, they rarely undermine the long-term thesis or profitability of these companies, and often create short-term windows in which to invest.

The VT Tyndall Global Select Fund B Acc (GBP) rose by 2.26% over the month reaching a new all-time high, helped by a variety of holdings such as United Rentals, NVIDIA, Fiserv, American Express, and Microsoft. Detracting from performance were Sika, Zebra Technologies, Nike, Becton Dickinson & Zoetis, all of which failed to make gains over the month. The rolling 12-month performance now stands at 14.79%.

Fund Activity and News

The Fund created a new position in Schneider Electric during the month. We had initially held off from investing after the retirement of Jean-Pascal Tricoire, who led the company from 2006 until last year, and was considered as one of the most effective CEOs in the capital goods sector.

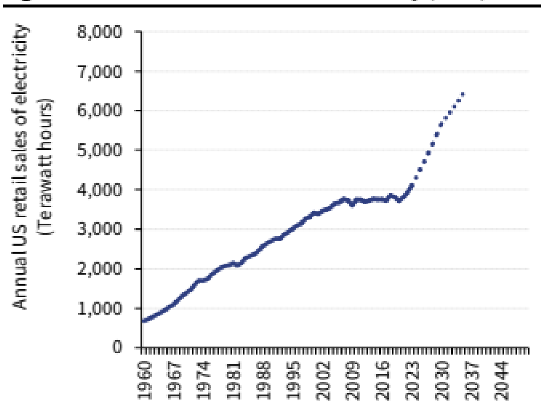
The new CEO, Peter Herweck, has worked at Schneider (or as CEO of Aveva, which was acquired by Schneider last year) since 2016, having previously worked for Siemens. He laid out is framework for the company at their capital markets day in London last year, and we are encouraged that he is continuing with his predecessor's strategy and building on the foundations that he laid. Digging into his background it is also interesting that he did his thesis of Artificial Intelligence, which may well prove to be of significance as Schneider becomes a key enabler for the build out of data centres; it already has contacts to help Microsoft and Google to build out their capabilities.



Schneider Electric is a key enabler in multiple global mega-trends, namely digitalisation, climate change, urbanisation and electrification, and through growing its revenues from services, has a significant amount of recurring revenues that help to generate free cash flow of €4bn that more than supports further investment in research and development. The addressable market for the areas of these trends that Schneider covers are expected to increase by 6-7% per year to over €500bn by 2027.

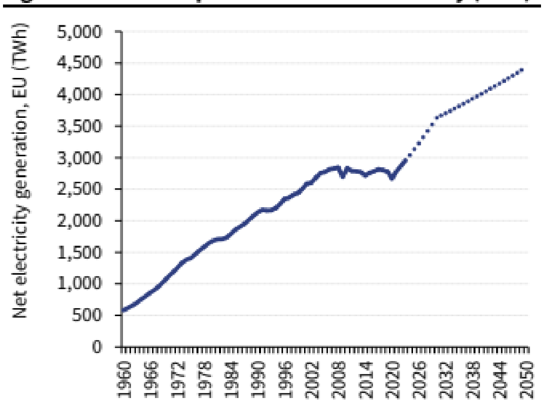
As the global leader in electrification, offering complete end to end solutions as well as consultancy assistance, Schneider stands to benefit from the growth in electricity demand. The US consultancy, Grid strategies recently increased its forecast for electricity demand and reported that growth in demand had more than doubled in the past year. Schneider believes that, as the most energy efficient source, electricity will increase from 20% to 30% of the global energy mix by 2030 and to 50% by 2050.

Fig 25: Annual US retail sales of electricity (TWh)



Source: Redburn Atlantic based on EIA, NERC and Grid Strategies

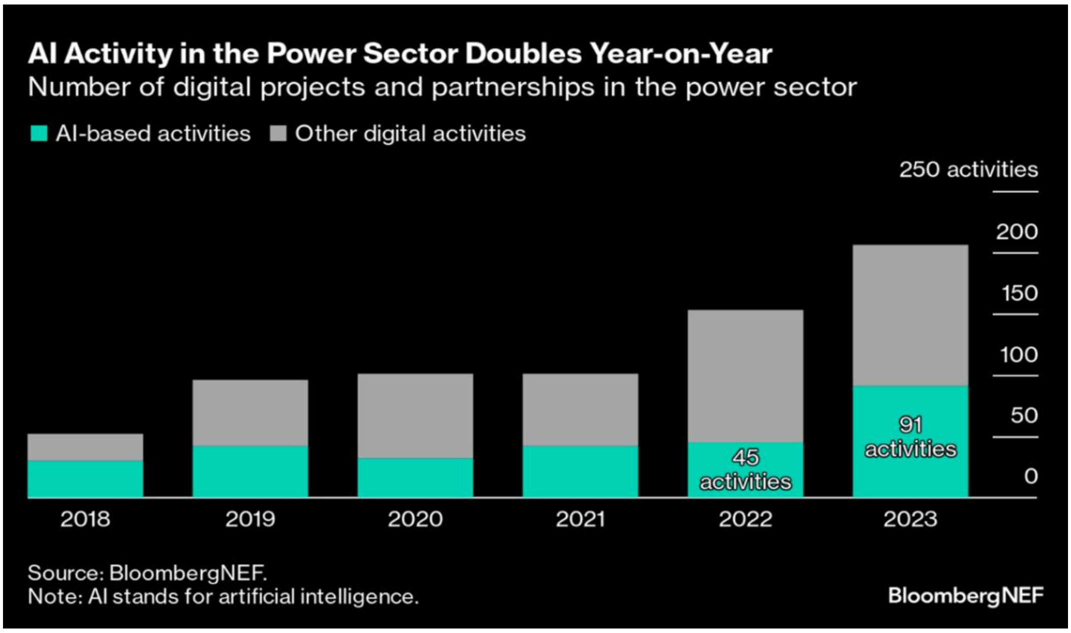
Fig 26: Annual Europe retail sales of electricity (TWh)



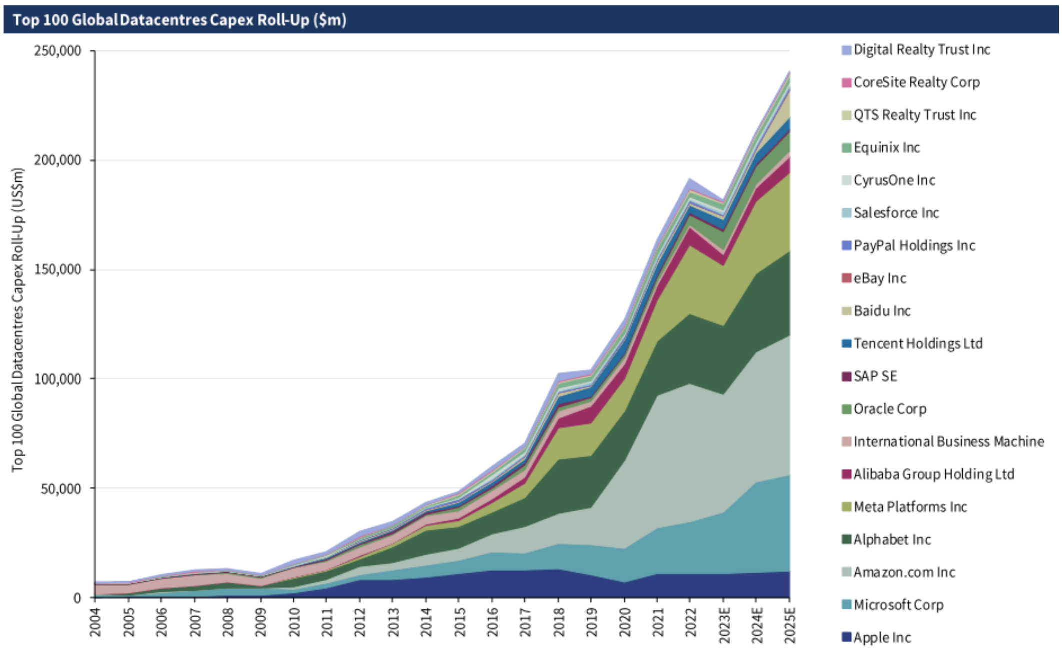
Source: Redburn Atlantic based on Eurostat

One example of the increase in power demand comes from the build out of data centres, which is substantial. With AI growth is still in its infancy, this is likely to be a multi-year tailwind as electrical equipment accounts for 43% of data centre capex. Most data centres can support peak rack power of about 10-20kW, however, AI has 10x greater density than regular data centre usage, and 4x the requirement at the rack level as servers must move from CPU to GPU, so investment in infrastructure is required to facilitate this.

Nvidia's H100 GPU is widely seen as the gold standard for AI roll-out. It has significantly greater power consumption that of its previous generation A100 and V100 GPUs, but given that the performance is over 30x that of the V100, the increase in power consumption outweighs the cost of spending on the physical infrastructure.

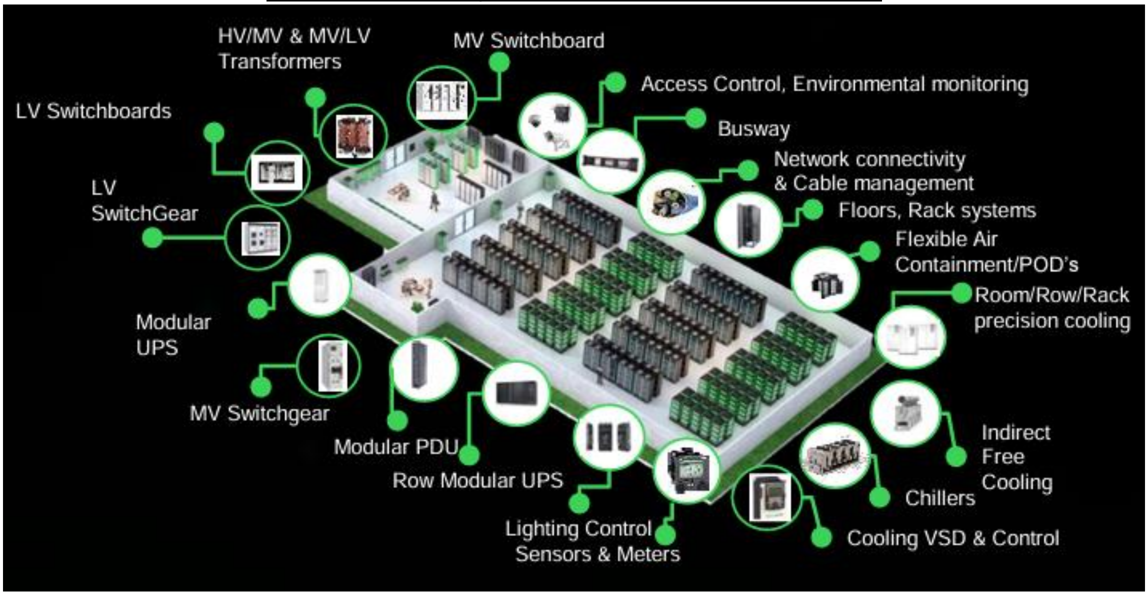


Almost the data centres are now in the process of rolling out AI solutions in various forms, leading to a significant increase in global capex. The need for greater cooling capability, higher voltage supply and larger server racks are just a few of the implications of this new era of technology, playing into the hands of the hyper-scalers and their deep pockets, while the older data centres may struggle to retrofit their warehouses to effectively deploy AI solutions but have little choice if they are to servive.



Source: Redburn

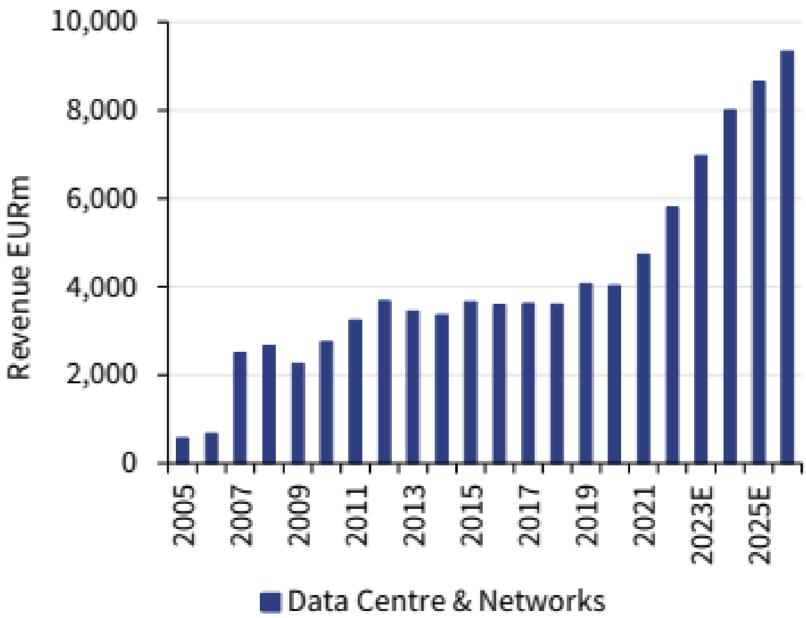
Schneider's ability to offer an end-to-end solution.



Source: Schneider

Consequently, Schneider, as the market leader in electrical distribution and the most complete offering for data centre's electrical needs, estimates that the data centre and network market will grow at over 10% CAGR through to 2027.

Schneider's revenues from data centres and networks



Source: Schneider

We believe that electrification will be a dominant theme as the companies look for more energy efficient solutions and adapt for a more data-driven world driven by an increased workload put on the cloud and their adoption of AI strategies. We therefore initiated a position in the global leader who has the reach and ability to provide companies worldwide with the products and services that they will require to achieve their goals.

Richard Scrope, Fund Manager, VT Global Select Fund, 31st December 2023
Data source (unless otherwise stated): Bloomberg.

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