As at end of November 2017

Pictet-Security-R EUR

Market review

Strong economic data and progress on US tax reform ensured that worldwide equities continued their strong run during November, picking up another 2.2%. The US was the best performing developed equity market in local currency terms, with the MSCI US index gaining some 3%. The S&P 500 index saw the thirteenth successive month of positive total returns for the first time in over 90 years. European equities fared less well, and ended the month in negative territory on the month as a stronger euro weighed on stocks of export-dependent companies. The rally in technology stocks appeared to be fading. They ended the month virtually flat, having gained almost 40% since January. All industry sectors generally performed well, with the exception of materials, which was up less than 1% on the month. In our security universe, physical security products largely outperformed other segments with 2.3%, the security services sub segments was also solid with a 1.6% performance for the month. In contrast, IT security products was weak, down by 0.2% as it impacted by the rotation away from technology names.

Performance analysis

The fund underperformed the global equity market last month. The best relative segment was the physical security products. The security services sub segment also contributed nicely. The IT security product sub segment detracted from performance, impacted by poor results and the rotation away from technology names at the end of the month. In terms of companies, the best contributors to performance were 3M (physical security products), StanleyBlack & Decker (physical security products) and Shimadzu (physical security products). On the negative side, Check Point Software (IT security products) and Symantec (IT security products) were the worst performers as these companies posted uninspiring results for the last quarter.

Portfolio activity - overweightings & underweightings

During the month, we slightly increased physical security products as the expense of the IT security products sub-segment. In physical security products, we increased our transportation safety exposure through Continental AG and by adding Denso, benefiting from its investment in new ADAS technology, and having presented an upbeat long-term plan. We also added Bruker, the company is benefiting from better academic spending. In security services, we have continued to adjust our positioning in secure electronic payment processing, reducing Fidelity National Information Services and First Data, and increasing Vantiv and Total System Services. Lastly, in IT security products we trimmed our position in Symantec and Check Point Software Tech, due to their poor results. We also took profits among our semiconductor stocks, including Infineon and KLA-Tencor. We built a new position in Sophos PLC, a leading global provider of end-user and network IT security solutions.

Market outlook

Given the persistent uncertainty surrounding the current state of the economy, we believe that securing countries' critical infrastructures, protecting citizens' integrity and ensuring the ability of businesses to meet their objectives is a top priority. We therefore remain confident about the fund's ability to outpace the global equity market on earnings and cash-flow growth over the next few years, as stricter regulation is likely to remain a key driver for security going forward, IT systems and cybersecurity remain a priority for governments and companies. We are therefore confident that the fund is an attractive investment opportunity to capture a long-term trend with strong fundamentals and good diversification properties.

Portfolio strategy

Investor sentiment is still pretty optimistic about the global economy. Business cycle indicators paint a good picture of the global economy. In the US, manufacturing, consumption and labour market data point to strong economic conditions. The euro area's recovery is on track thanks to consumer spending in Germany. Japan is also enjoying positive momentum, with the Bank of Japan's monetary stimulus facilitating a broad-based recovery in the consumer sector. In China, we think economic growth is likely to remain stable around the current annualised rate, supported by consumption and investment. However, further interest rate hikes by the Fed – coupled with a steady draining of central bank stimulus – may weigh on financial markets later this year, particularly on emerging market assets. Consequently, we currently believe that a portfolio which is well-balanced geographically is likely to deliver stronger results. We favour companies that have a strong structural positioning, can expand margins, grow earnings and have plenty of cash. Our current sector allocation is physical security (36%), IT security (21%) and security services (42%).

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