# Invesco Europlus Fund

**Quarterly review |** As at September 30, 2022

## Investment philosophy

The investment philosophy for Invesco Europlus Fund is simple; the portfolio management team (the "team") invests in primarily European high-quality businesses, with strong management at an attractive price. The team believes this philosophy will allow them to deliver a high active share portfolio that targets outperformance over a market cycle.

## Performance summary

- Invesco Europlus Fund, Series I returned -6.34% over the third quarter of 2022, underperforming its benchmark, the MSCI Europe Index (net – C$), which returned -4.29% over the same period

## Key contributors to performance

- The Fund's relative performance benefited from stock selection and an overweight in the communication services sector, as well as the fund's cash weight during a period that saw negative performance for the index
- From a country perspective, positive returns from the Fund's holdings in Poland, Germany, and Finland contributed to relative performance
- The top relative contributors over the period included Scout24 SE, a leading property portal in Germany for residential and commercial real estate sales and rentals, and Benefit Systems SA, a leading provider of employee benefit programs and solutions based in Poland

## Key detractors from performance

- Stock selection in the healthcare, industrials, and consumer discretionary sectors detracted from relative performance, as did a lack of exposure to the energy sector, the best performing sector in the benchmark during the period
- From a country perspective, holdings in France and the United Kingdom, the two largest country weights in the portfolio, detracted from relative performance
- The top detractors from Fund performance over the period included Virbac SA, a French pharmaceutical company that specializes in veterinarian products and services, along with Eurofins Scientific SE, one of the world leaders in the testing of food, environment, pharmaceuticals, cosmetics and consumer product industries, and Howden Joinery Group, a leading U.K. supplier of kitchens and joinery products to the building trade

## Portfolio activity

- The team maintains its bottom-up and long-term investment approach, but the Fund saw raised portfolio activity in the third quarter of 2022 relative to recent periods. On balance, the shifts have been toward high-quality businesses that reflect our preferred growth characteristics along with defensive qualities, as illustrated by an increase in the portfolio's consumer staples sector weight. We continue to seek a balance between the improved long-term opportunity that we see in the market while accounting for elevated near-term macro risks.
- During the period we initiated four new positions, including **Diageo PLC**, a leading global, diversified spirits company with a top collection of brands. Diageo is a company that we have owned in the past, having closely followed it for over ten years. We think it is extremely well-managed and holds robust and consistent earnings power. We project the company should maintain strong growth potential in a variety of market conditions through its diversified global presence, pricing leverage in its premium product offerings, and cost advantages due to its leading scale and distribution capabilities.

- To fund the above and other selected shifts in the portfolio, we also made small reductions in a few positions that had seen recent positive swings to manage our preferred risk-adjusted portfolio weightings. This included trims to **Prosus NV** following a strong second quarter, along with **Scout24** and **Benefit Systems**, which were the two top contributors during the third quarter as the stocks saw positive returns that diverged from the negative moves in most other equities.
- The Fund's cash weight remains elevated at 9% as the team continues to maintain a disciplined investment approach to find opportunities that meet our criteria. The team is monitoring companies we favor given increasingly attractive entry points amid ongoing volatility and the rotation out of smaller-sized, high-quality growth companies.
- From a country perspective, the Fund's largest overweight is in Luxembourg on account of Eurofins Scientific SE, one of the larger holdings in the portfolio, as well as Poland due to its position in Benefit Systems SA.
- The Fund continues to have an overweight in industrials, information technology and communication services, while having the largest underweights in financials, consumer staples and materials. The Fund does not hold any exposure to the energy, utilities, materials, or financials sectors.

## Investment outlook

The third quarter of 2022 was challenging for global markets, with most major asset classes posting losses. Virtually every country in Europe has been impacted by the sanctions on Russia, which has resulted in higher natural gas and electricity prices for companies and consumers alike. Continuing inflation has led to continued aggressive monetary policy tightening by many central banks in Europe and elsewhere, including 150bps by the US Federal Reserve. There are increasing signs of slowing economic growth, while the US dollar continued to strengthen against both developed and developing market currencies, acting as an additional headwind for many global economies.

Amid this backdrop, equities experienced volatility during the period, making gains early in the quarter, only to falter in mid-August and hit a notable decline by the end of September. Businesses are operating in an increasingly uncertain forward environment. While we are likely to continue to see economic challenges in Europe, we believe much of the pessimism has translated into stock prices and that there are increasingly attractive opportunities in quality businesses, particularly when using a medium-to-long term outlook.

The Fund's returns during the quarter broadly mirrored volatility in the markets as the Fund experienced a strong July, both on an absolute basis and relative to the benchmark, then giving back some of its returns in August before a weak September. Given the Fund's growth bias, the Fund's swings broadly mirrored the market's growth bounce early in the quarter and weakness late. Overall, the small-cap bias among our European holdings served as a primary detractor impacting the Fund's performance relative to the benchmark over the full quarter. To illustrate, small caps in Europe underperformed large caps by over 5% during the third quarter, as measured by MSCI indices, with the difference even starker for growth companies, with small cap growth companies underperforming large cap growth companies by over 7%.

Despite uneven performance across both business types, the team has generally seen downward pressure continue for higher valuation stocks with selected outperformance in cyclical areas that we tend not to invest in, challenging our short-term performance. Historically, higher valuation stocks have declined while rates rise, as investors are less willing to pay higher multiples for future growth. We focus on companies that we believe can deliver superior long-term returns due to high structural growth potential and competitively entrenched positions, rather than cyclical, macroeconomic driven earnings. Notably, we do not own any businesses in the energy sector, which has detracted from our relative performance. The energy sector was the best performing sector in the benchmark during the third quarter and has been only sector to post a positive return during both the third quarter and year to date 2022.

While recent period returns have been challenging, we think our portfolio stands to benefit, as it is our experience that beyond the short term, the market ultimately refocuses on fundamentals and rewards stocks that continue to reflect strong earnings. We believe the long-term capital appreciation potential has improved meaningfully for quality companies, and in many cases, valuations in European businesses appear to be increasingly compelling.

Overall, we feel current valuations are already discounting a lot of the bad news. It feels like we are certainly closer to the trough in terms of equity valuations in Europe. We are increasingly finding opportunities to buy high quality businesses at valuations not seen in the last few years, perhaps with the exception of the brief period in March 2020 when the pandemic first hit. In our modeling, we are beginning to see more and more companies trading at discounts to our estimates.

Moreover, the value of the Euro and the British Pound reached multi year and record lows respectively during the quarter, essentially discounting high inflation expectations. The plunge in valuations and currencies driven by fear of inflation and assumption of an eventual recession is, in our view, quite evident when dissecting index level performance. The FTSE All-Share General Retailers Index was down over 40% YTD, exemplifying the pessimism toward future discretionary spending. For these reasons, with a multi-year view, we believe that both lower equity valuations and currency levels in Europe provide strong return potential for our European holdings.

The UK economy in particular has recently been in a period of turmoil. In our view, it is worth noting that our portfolio is underweight to the United Kingdom relative to the benchmark, and most of the names we hold in the UK are global in nature with many only having a portion of their revenue generated in the United Kingdom. However, one holding that is more UK-centric holding, Howden Joinery PLC, has a valuation that is among the best we have seen in years, beaten down by concerns over the UK economy, despite the business seeing strong momentum with growth and market share gains in recent reports.

As a cost leader through its vertically integrated model, Howden is, in our view, well positioned to continue winning market share as consumers become more cost conscious. In a consumer-driven recession, demand may slow, but this already seems reflected in the price. Additionally, we believe there are a lot of counteracting forces which may lead to positive demand surprises, such as the impact of the recently announced government stimulus, and more consumers potentially opting to renovate their current homes rather than move.

As such, we believe our exposure we do have in the UK is sound when looking at it from a multi-year perspective. The combination of owning strong businesses in their respective verticals, attractive valuations, and a pound that is at multi-decade lows, relieves some concern around the negative news cycle we are currently seeing.

We are seeking to take advantage of what we see as discounted valuations, while being mindful of the near-term uncertain economic outlook. We remain long-term investors but on balance, recent portfolio activity in our holdings has seen some shift toward companies that hold our preferred quality characteristics, but importantly, also ones that hold defensive qualities that we believe will benefit portfolio construction and serve the portfolio well in a variety of forward environments. To illustrate, our consumer staples weight has increased. We still remain confident in our high-quality, high growth European businesses. However, we will continue to maintain a risk-considered perspective in taking advantage of the long-term opportunities we see with a view of likely near-term volatility.

The Select Equity team are bottom-up, long-term investors that seek high-quality businesses with attractive growth prospects and sustainable competitive advantages. While the team is invested in companies for their long-term potential, we continue to closely monitor what many investors see as heightened macro risks. We are confident that our thesis for our Portfolio companies remains intact, and while recent period headwinds have been challenging to Fund performance, the team remains optimistic. We maintain high conviction in a collection of businesses at prices we view as undervalued and believe the Fund is well-positioned moving forward.

## Important information

Sources: Invesco Canada Ltd. as at September 30, 2022. Data and comments are sourced from Bloomberg, Morningstar, Invesco, and various news and company reports.

The above securities were selected for illustrative purposes only and are not intended to convey specific investment advice.

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Performance of Invesco Europlus Fund, Series I as at September 30, 2022:

| | 1-Year (%) | 3-Year (%) | 5-Year (%) | 10-Year (%) |
|---|---|---|---|---|
| **Invesco Europlus Fund, Series I** | **-38.96** | **-3.56** | **-0.26** | **7.72** |
| MSCI Europe Index (Net) C$ | -18.44 | -0.49 | 0.63 | 6.96 |

The views expressed above are based on current market conditions and are subject to change without notice; they are not intended to convey specific investment advice. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although we make such statements based on assumptions that we believe to be reasonable, there can be no assurance that actual results will not differ materially from our expectations.



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