BankInvest Equity Income Strategy

December 2022 – Performance review *(all returns are gross of fees in DKK and are not audited).*

December 2022 saw mixed performance, as the absolute return was negative by -4.78%, while the relative performance was positive by +15bp. For the whole of 2022, the absolute return was negative by -1.58%, while the relative return was negative by -307bp.

At sector level, the highest positive contributions in the month came from Financials (+29bp), Consumer Disc. (+12bp) and Utilities (+10bp), while Industrials (-31bp), Materials (-23bp) and Health Care (-4bp) showed the largest negative sector contributions.

Absolute Performance, December 2022					
Company	**Sector**	**+ Return**	**Company**	**Sector**	**- Return**
TAG Immobilien	Real Estate	6,0%	Microsoft Corp.	Information Technology	-9,3%
Sanofi	Health Care	3,9%	Avery Dennison	Materials	-9,4%
Carlsberg B	Consumer Staples	3,3%	TFI International	Industrials	-10,1%
CMS Energy	Utilities	0,0%	UPS	Industrials	-11,6%
BRENNTAG	Industrials	-0,5%	CVS Health	Health Care	-11,8%
Average, Top-5		**2,5%**	**Average, Bottom-5**		**-10,4%**

Relative Performance, December 2022					
Company	**Sector**	**+ Contribution**	**Company**	**Sector**	**- Contribution**
Carlsberg B	Consumer Staples	0,14%	Pfizer (BM)	Health Care	-0,09%
TAG Immobilien	Real Estate	0,13%	Avery Dennison	Materials	-0,10%
Intel Corp. (BM)	Information Technology	0,11%	ABM Industries	Industrials	-0,10%
Texas Instrument (BM)	Information Technology	0,10%	Microsoft Corp.	Information Technology	-0,10%
Sanofi	Health Care	0,10%	TFI International	Industrials	-0,11%
Sum, Top-5		**0,57%**	**Sum, Bottom-5**		**-0,49%**

BM = Benchmark stock

Carlsberg (CARLB DC) outperformed in December, despite no material company news. The company is building its scale in Canada, announcing a minor acquisition of a Canadian brewer with DKK ~565m in revenue, corresponding to ~1% of Carlsberg's revenue.

TAG Immobilien (TEG GY) outperformed the market in December, despite even higher German bond yields. On a roadshow TAG stated that its upcoming debt maturities in 2023 are already covered, and that it still expects to repay the EUR 250m bridge loan with proceeds from disposals. The progress of the disposals and especially the selling prices compared to book value will be key for TAG in 2023. Following a difficult year with TAG down -74%, the stock is now trading at ~6x P/FFO (~17% earnings yield), suggesting that a lot of bad news are priced in.

The semiconductor companies, including Intel (INTC US) and Texas Instruments (TXN US), had a poor month. The largest US maker of memory chips, Micron Technology (MU US), provided a disappointing outlook with its Q1 report, suggesting that the weak demand for PC and smartphone components will drag on. Furthermore, Micron significantly cut its capex outlook for 2024, in contrast to the market expecting a recovery in spending on Wafer Fab Equipment (WFE). The update from Micron suggests that the downcycle in semiconductors is deeper and more prolonged than expected by the market. Both Intel and Texas Instruments are large in benchmark, contributing positively to the relative performance in December.

Shares in Sanofi (SAN FP), GlaxoSmithKline (GSK LN) and Pfizer (PFE US) outperformed following the news that a US district judge dismisses the many lawsuits linking the popular heartburn drug "Zantac" with cancer. The ruling removes the potential liability linked to the Zantac litigation, which was feared to be significant (in billions). While this doesn't necessarily mean the end of litigation, it is a material win and removes the overhang on the beforementioned shares. GSK is the brand originator of Zantac and thus increased the most following the news. Additionally, to our positive surprise Sanofi decided to walk away from the large transformative acquisition of Horizon Therapeutics (HZNP US), citing the price being too high.

TFI International (TFII CN) had a poor month, as data shows further declines in Less-than-truckload (LTL) volumes. In addition, the competitor FedEx (FDX US) downgraded its full-year guidance, reflecting continuing market weakness. FedEx saw sharp declines in LTL volumes with shipments down -11% in November, a worsening from -3% in June. FedEx also reported the first Q/Q decline in LTL yields in a long time, as customers are turning more price sensitive, opting for budget-friendly shipping solutions instead of priority services, impairing the LTL yields.

Tech stocks, including Microsoft (MSFT US), underperformed as the FED hiked interest rates yet again with more hikes likely to come. The market hoped for a slowdown in rate hikes, due to the recent decline in inflation. Microsoft declined -9.3% in December, compared to the Nasdaq index dropping -12.4% and our benchmark down -4.9%.

US facility service operator, ABM Inc. (ABM US) reported decent operating trends in the quarter and financial year ending in October 2022. Even operational guidance for FY-2023 was acceptable. However, with a large proportion of debt on variable interest rates, EPS guidance for FY-2023 was on the low side of expectations as interest expenses for 2023 surprised negatively. The stock ended the month down -5.9% (in USD) (in-line with S&P 500).

Packaging company Avery Dennison (AVY US) commented that volumes was trending below plan in Q4-22. The lower volumes are probably a result of lower end-demand in some sectors and de-stocking in the supply-chain. The stock underperformed the S&P 500 by more than 7% on the day. For the whole month, the stock was down -9.4%.

Review of full year 2022

In 2022 dividend investing showed its defensive qualities as the MSCI World High Dividend Yield Index (strategy benchmark) performed much better than the MSCI World Index. The former was up +1.26% in DKK, while the latter was down -12.53% in DKK. Unfortunately, our performance could not live up to benchmark performance, and the strategy saw a -1.58% return in 2022, some -307bp behind benchmark. We estimate that tobacco and fossil fuels account for -91bp of that underperformance. Since we do not invest in either tobacco or in fossil fuels, the residual underperformance of -216bp is more representative of how the portfolio was managed in 2022.

Absolute Performance, 2022					
Company	**Sector**	**+ Return**	**Company**	**Sector**	**- Return**
Merck	Health Care	58,6%	Capgemini	Information Technology	-26,9%
Eli Lilly	Health Care	42,6%	Lowes Companies	Consumer Discretionary	-27,5%
Travelers	Financials	29,8%	FIS	Information Technology	-28,6%
AstraZeneca (US)	Health Care	26,9%	Evonik	Materials	-34,4%
Allstate Corp.	Financials	25,4%	TAG Immobilien	Real Estate	-73,1%
Average, Top-5		**36,7%**	**Average, Bottom-5**		**-38,1%**

Relative Performance, 2022					
Company	**Sector**	**+ Contribution**	**Company**	**Sector**	**- Contribution**
Intel Corp. (BM)	Information Technology	0,72%	Microsoft Corp.	Information Technology	-0,52%
Eli Lilly	Health Care	0,63%	AbbVie (BM)	Health Care	-0,53%
Allstate Corp.	Financials	0,44%	Capgemini	Information Technology	-0,54%
Elevance Health	Health Care	0,40%	Evonik	Materials	-0,74%
Travelers	Financials	0,39%	TAG Immobilien	Real Estate	-2,10%
Sum, Top-5		**2,59%**	**Sum, Bottom-5**		**-4,43%**

From the absolute performance table, it is clear that "big pharma" had a very good year in 2022. Firstly, as a defensive industry, pharma usually does well in a bear market. Secondly, most of our big-pharma investments have seen good underlying performance in terms of existing products and pipeline news.

Eli Lilly (LLY US) have seen great progress on two fronts in 2022: diabetes and obesity on the one hand and Alzheimers disease on the other hand. In 2022, Eli Lilly launched Munjaro against diabetes and the launch was extremely successful, exceeding market expectations by a large margin. We expect Munjaro to be approved against obesity in 2023, adding even more potential to this product, which seem to have a slightly better profile than rival products from Novo Nordisk (NOVOB DC). Furthermore, towards the end of the year, Eli Lilly provided new information about its pipeline product "retatrutide" (also just called GGG), which appear to have an even better profile than Munjaro. Hence, the diabetes franchise seems to have many years of high growth ahead. Starting with Biogen (BIB US), Alzheimer drugs was very much in the focus in 2022. Hopes were also high for Eli Lilly and Roche (ROG SW). Afterall, Alzheimers is a massive untreated opportunity for the pharmaceutical industry. Towards the end of the year, Roche's product effectively failed. Eli Lilly's product, "donanemab", is still in Phase-3 and we expect news in late 2023 or early 2024. There is of course always a risk that Alzheimers drugs will fail, which the Roche experience witness. We estimate that "donanemab" is worth around 4% of the current share price but reckon that the market has a higher value estimate than us. Hence, the share price risk is probably in the range of 5-10% in case of a failure. As the Eli Lily stock did well during most of the year, we have gradually decreased our stake to reduce our risk exposure.

Another big pharma stock that outperformed in 2022 was Merck (MRK US). Firstly, the stock has benefitted from the defensive shift to pharma, helped by some mean-reversion after a lackluster 2021, with P/E now at about peer group average (excl. Eli Lilly). Secondly, Merck has had good execution with +20% EPS growth in 2022 and reporting several "beat-and-raises". The typical bear argument that Merck is too dependent on Keytruda, which faces patent expiry in 2028, has been largely ignored in 2022. Merck's pipeline is gradually filling, and with solid performance from Keytruda and Gardasil, binary event risks have been very limited, making Merck a relatively defensive play. Risk to Merck remains large M&A with use of equity.

In the above performance tables, we find the insurance companies Allstate (ALL US) and Travelers (TRV US). Typically, in times of uncertainty and rising interest rates, insurance is seen as a safe haven. Allstate (ALL US) eventually managed to hike its auto insurance prices, offsetting the elevated cost inflation in auto insurance (i.e. high used car prices and higher costs for personal injuries). Starting the year, Allstate's auto-margins was depressed and posted worse-than-expected underlying margins, missing on combined ratio. After several quarters of adverse price-cost trends, costs eventually came down from all-time- highs, and Allstate managed to hike prices across states with regulators slowly approving the hikes. We now see a positive "price-cost momentum", and the stock has re-rated accordingly.

The German chemical company, Evonik (EVK GY), had a poor year – in-line with the European chemical sector. The poor performance was largely a result of the Ukraine/Russia conflict, with the stock dropping -23% in February/March 2022. Since then, the market has been nervous about whether Evonik had access to energy supplies in the event of a Russian gas supply stoppage. Evonik assured that it can substitute up to 40% of its natural gas needs with alternative fuel sources such as coal, oil, and liquefied petroleum gas (LPG). Additionally, the economic slowdown has been a major headwind to Evonik. Consensus' EPS estimates has dropped -18%, while P/E de-rated by -23%, highlighting a difficult year for the stock.

In 2022 we saw a forceful rotation between Value and Growth, driven among other things by higher interest rates. The Growth-like stocks Microsoft (MSFT US) and Capgemini (CAP FP) thus performed poorly. Microsoft faced headwinds from weakness in PC markets, while the big disappointment was the deceleration in Azure (Microsoft's cloud business). However, other large public cloud players (i.e. Amazon's AWS) also witnessed a slowdown. Thus, the slowdown in cloud spending has been largely due to the macro uncertainty. While the pace of activity may be slowing, the overall secular trends remain intact. Microsoft's and Capgemini's P/E decreased by -32% and -39% respectively in 2022, while EPS estimates increased, leaving an attractive risk/reward for both stocks.

One stock in particular draw attention in 2022 and that is German residential real estate company, TAG Immobilien (TEG GY), which saw a -73% decline (in DKK, -74% in EUR) in the share price and alone contributed -210bp to relative performance. While the "sector" (Vonovia and LEG Immobilien) declined on average 52% in 2022, there is still -22% TAG specific underperformance, which we ascribe to three factors: first dilution from equity issue (-8%), cancelling of the dividend for 2021 (-4%) and other, including credit rating downgrade (-10%). In the table below, we have tried to breakdown the 74% drop in share price (in EUR) into different factors. Most of the fall in the share price can be related to increased interest rates, which affect the discount rate and the growth rate in FFO and DPS as interest expenses increase much faster than revenues in the medium term.

	Share price / sh	Estimted impact	Index	Comments
Share price, start-of-year	**23,49**		**100%**	**Share price at end-2021**
Increased discount rate		*-9,21*	*-39%*	Increase in 10-year German government bond yield
Lower FFO growth		*-3,80*	*-16%*	Increased interest expenses, Lower growth in Poland
Dilution from equity issue		*-1,96*	*-8%*	Partly refinancing of bridge loan
Cancelling of dividend for 2021		*-0,93*	*-4%*	Assuming dividends is resumed for 2022 and paid in 2023
Other factors		*-1,55*	*-7%*	Other, including credit rating downgrade
Share price, end-of-year	**6,04**		**26%**	**Share price at end-2022**

Note: All-other-things-equal impact on start-of-year share price.

Buying, selling, and other matters

No new shares or selling of shares in December. For the whole of 2022, we have bought four stocks (ABM Inc., Amdocs, FIS and J.P. Morgan) to the portfolio and sold five stocks (Bunzl, Kimberly-Clark, Rogers Communications, Lowe's and IBM). The portfolio started the year with 52 stocks and ended the year with 51 stocks. Selling only five stocks out of around 50 stocks, yield an annual turnover rate of around 10%. That is the lowest rate since the strategy was initiated in 2011. The average turnover rate is around 23% since inception. Why such a low turnover rate in 2022? At the start of the year, it was probably because "everything was expensive" and we could not find attractive cases. As the year progressed and the stocks in the portfolio also saw declining share prices, it was probably because stocks in the portfolio now had an attractive "risk-reward" profile.

Valuation of the asset class

According to MSCI, dividend stocks are cheaper (P/E Fwd) than the broader world index (MSCI World). Dividend stocks naturally also carries a higher dividend yield. Data is from November 2022 as data from December 2022 is not yet available.

	Div Yld (%)	P/E	P/E Fwd	P/BV
MSCI World HDY	3.65	13.65	13.26	2.58
MSCI World	2.08	17.98	15.92	2.84

Source: MSCI.

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