US Equities
Investment comment

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Document intended mainly for professional investors

The facts: Despite initial hopes of a quick resolution, the strikes on Iran continued throughout the month without any clear sign of success. Economic indicators and the few quarterly earnings released in March were almost invisible behind the spreading impact of the war on global business.

The war in the Middle-East, which started hours after the close of February's last market session, was obviously the defining factor of the month for equity investors. In the first few days, it was revealed that the initial strikes had eliminated more than 40 high-ranking officials of the Iranian Islamic regime, including the "supreme leader" himself, which suggested that the attacks had been carefully prepared, with strong intelligence on the ground. The assumption at that stage was that the opposition in Tehran and overseas would manage to reignite the upheavals of the previous few months, and remove the mullahs and their supports. However, **it soon became clear that things were not that simple, and that the regime had deeper roots and stronger resources than just the few dozens of targets hit in the first few hours**. Tehran's ability to keep striking back under heavy fire and its efforts to maximize the conflict's consequences on the rest of the world had probably been underestimated, and so had been the cost asymmetry for the two camps. With relatively few, random strikes on neighboring countries, Iran managed to halt air traffic and tourism, with serious consequences for the Emirates, in particular. Meanwhile, it also imposed a virtual blockade of the Strait of Hormuz, through which a large part of the region's exports is normally shipped. **The lack of alternative routes and storage capacity soon resulted in the idling of many industrial sites around the Gulf**, with an immediate impact on global supply chains. Asia, which has a high dependency on the Middle-East for its energy imports, was hit particularly hard, but the effects went well beyond the obvious case of oil and petrochemicals. Towards the end of the month, **even the semiconductor industry was reporting risks of production disruptions due to a shortage of helium**, a gas which plays a crucial role at several stages of the chip manufacturing process.

Investors thus kept a close eye on everything that could give hints about the likely duration and outcome of the conflict, including Donald Trump's declarations, which kept blowing hot and cold. **After initially promising that everything would be finished swiftly, the US President and his aides started preparing the opinion to a longer timeframe**, while regularly making conflicting statements about the evolution of the situation. It was not exceptional to hear, within the same day, commitments to a continuation "until Iran's full capitulation", threats of an appalling escalation in strikes if the negotiations did not progress and comments suggesting that all key objectives, including the regime's replacement, had been reached. At the end of the month, a rumor developed that negotiations were underway with Iranian representatives, but nothing concrete was available to confirm the news, which media reported had then been denied by Tehran.

It gradually became obvious, anyway, that, even if the fights were to cease quickly, some damages had already been made, and infrastructures would take time to repair and restart. Qatar, for example, indicated that a natural gas

facility representing a significant percentage of its total shipments had been hit and would take several years to revert to its normal capacity. Concerns therefore went rising about both inflation and possible effects on core economic trends. The Federal Reserve and other central banks logically kept rates unchanged to "wait and see", but **a growing number of stress signs appeared**, particularly in the private debt market, with several funds limiting withdrawals.

Behind this turmoil, attention to the rest of the news was rather poor, and fundamental information such as economic indicators or corporate earnings hardly made it to the headlines, all the more as they related to periods prior to the February 28 strikes. Some of these figures, however, were surprising. Supply managers' optimism was among these. **The unexpected rebound of the ISM Manufacturing index was particularly hard to explain** as its two consecutive readings above 52 contrasted with the ten-months it had previously spent at or below 49.1. Sentiment was also strong in Services, where the ISM index reached its highest mark since November 2022, and consumer confidence (one of the few indicators already available for a post-strikes period) even continued to progress slightly in March, although from relatively depressed levels. Actual activity metrics in manufacturing, housing and retail were a lot less strong, but they were not inconsistent with the previous months. The Bureau of Labor Statistics pointed to a significant decline in non-farm payrolls in February, unemployment rose back slightly to 4.4% and various companies continued to announce job cuts. **Many of these were explained by AI-related developments**, sometimes thanks to productivity gains achieved with the technology, but often because the management was seeking savings to fund its AI investments. However, jobless claims did not seem to rise accordingly, probably because of baby-boomers exiting the workforce.

As regards corporate results, only about 20 S&P 500 members reported in March. Earnings were generally above expectations but, here again, investors were conscious that they did not mean anything for the future, and executives consistently stressed that 2026 targets would depend on the duration of the crisis in the Middle-East.

The effects: US equities initially resisted well, but lost ground in a volatile manner when Iran's retaliations blocked the Strait of Hormuz and damaged key facilities in neighboring countries. The S&P 500 index eventually lost 5.01%, but our strategy confirmed its multivalence and outperformed again.

The March 2nd session was the only one in the month whose close was above that at the end of February. The rise was marginal (+0.05% including dividends), but it illustrates that, at the time, many participants did not expect the war to threaten global growth. In the following few days, the S&P 500 index was down but it resisted better than many other country indices in Asia and even in Europe. As time went by, though, pessimism appeared to gain ground as more investors feared that the conflict would get stranded. In the end, **the broad index lost more than 5%, and would have done even worse without the strong (2.9%) rebound of March 31**, when investors suddenly started to believe that a de-escalation was possible. For most foreign investors, the strength of the dollar contributed to mitigate the loss, as usual when geopolitical tensions loom. For example, the US currency gained almost 3% against the euro during the month.

All GICS sectors lost between 3 and 9%, with the exception of Energy, which gained 10.3% as the barrel of WTI was trading above $90 for most of the month, and occasionally went above $100 despite Donald Trump's decision to alleviate sanctions on Russia, and the IEA's release of 400mln barrels from its reserves. **This did not prompt**

massive investments by E&P companies and, according to Baker Hughes' monitoring, the number of new rigs added in the USA in recent weeks remained rather moderate.

Unsurprisingly, the most resilient sectors outside this particular case were those perceived as defensive, like Utilities and Financials, which only lost between 3 and 4%. Technology also ended in that same range, for more specific reasons. Some companies, such as Hewlett Packard Enterprise, Dell, F5 and Akamai, benefited from business announcements stressing the continuing demand for AI, or received analyst recommendations after recent results. **The most frequent IT categories at the top of the performance ranking however were those directly impacted by the war**, like Palantir Technologies (software used in counterterrorism and operations management) and solar energy stocks (which were revived by prospects of durably high oil prices). Most cybersecurity stocks also did well.

At the other end of the ranking, Industrials was the weakest industry and lost about 8.5%. Manufacturing companies were hit by the threat of supply chain disruptions and higher input costs, but the sector also includes airlines, trucking and international carriers, many which suffered from rising fuel costs, which they were not always able to fully reflect in pricing. There were exceptions, though, as Delta Airlines raised its revenue growth projections, thanks to its price adjustment discipline and despite the ongoing effect of the partial shutdown on security checks at many US airports. **Surprisingly, two generally defensive categories, Healthcare and Consumer Staples, were among the weakest three in the March decline**. Health insurers and other services companies lagged, with Centene losing 27% mainly because it had reaffirmed its guidance instead of raising it. Eli Lilly, the heaviest weight in the pharmaceutical sector, also pushed the group down. Some investors questioned the remaining potential of the weight-loss franchise and the effect of price cuts, and the company also announced several acquisitions. As for Consumer Staples, which mainly comprise food producers and retailers, the problem was largely with the rising fertilizer prices and the lack of pricing power, but **Estee Lauder (-34%) was a drag too, as the market did not like its merger project with Puig**. Communication Services and Materials also fell more than 7%. In the former category, Meta Platform and, to a lesser extent, Alphabet (through YouTube) were found liable of failing to warn teen users of social media addiction risks. In the latter group, returns were extremely diverse. Packaging was partly impacted by the war, gold did not play its usual role as a refuge, resources that do not typically come from the Middle-East were under pressure because of the potential economic slowdown, but Lyondell Basel and Dow (petrochemicals) and CF Industries (fertilizers) all gained more than 30% to rank among the top four performers in the S&P 500 index.

In this weird backdrop, the Value investment style appeared to be resisting a little better than the Growth approach, and the relative resilience of large capitalizations (usually perceived as cash-rich and less vulnerable) helped the size-weighted index outperform its equal-weighted version by almost 110 basis points.

Our strategy again proved fruitful over the month, despite the significant background change. **This was a benefit of our past efforts to focus on visibility and execution quality, while reducing exposure to themes that were not supported by a clear rationale**. Our advance over the S&P 500 index softened slightly at the end of the month, but our gross return ended the period 0.88% ahead of the benchmark.

Consumer Staples and Energy were the two sectors where our stock selection proved disappointing in March. Our single position in the former, Dollar General, was impacted by the same factors that also weighed on many peers, but it also suffered from the announcement of a management transition. Its highly-regarded CEO, who had come back from a first retirement to turnaround the company, will retire again at the end of the year. In Energy, our stocks did well but their profile made them a little less sensitive to the extreme movements which were taking place on the barrel. **In both sectors, our relative exposure mitigated part of the effect, but we still lost a few basis points**. The same happened, to an even lesser extent, in IT and Finance.

Fortunately, **we also enjoyed a strongly positive effect from stock picking in several categories**. The best of these was Consumer Discretionary, which contributed about 50 bps. Bright Horizons Family Solutions gained more than 10% because its largely domestic focus and the announcement of a large share buy-back plan reassured investors. Burlington Stores also did well as its reported strong results, driven by solid same-store sales, and issued a 2026 guidance whose low end was well above consensus expectations as execution continued to pay off. Industrials added about 45 bps with the strong return of our only solar stock Nextpower (+14.7%), the continuing strength of Vertiv Holdings (which keeps making tuck-in acquisitions and winning major contracts), and the resilience of Waste Management. Finally, Communication Services contributed about 33bps to our excess return. Pinterest and T-Mobile US were the main direct contributors, but our absence from Meta Platforms also helped significantly.

In addition, despite our significant overweight in Healthcare, which was one of the weakest performers, we did not lose anything there, as our successful stock picking more than offset the detrimental effect of the sector weight spread.

Our decisions: Our stock selection went through a third consecutive month without any change, a very unusual situation due to the poor visibility preventing any clear-cut analysis. We thus still hold the same mildly defensive portfolio, whose stance looks well suited for the backdrop.

Given that the rise in geopolitical tensions had already been taken into account in our scenario for some time, the new situation caused by the strikes on Iran did not create an unexpected environment, nor did it trigger further portfolio adjustments. While it could have looked logical to further cut our exposure to economically sensitive stocks, or buy more defensive securities, **we considered that it was either too late or too early to do so**. The idea was that what had been happening so far was already discounted, and that the next leg could go in any direction, since investors were still paying attention to Donald Trump's randomized comments on the war. This was limiting the influence of fundamentals and other factors we typically use in our analysis. As a result, our holdings list remains the same as that we had at the end of 2025.

Our sector exposures also remain largely unchanged, including in their comparison to index weights. **The only notable exception concerns energy, where our long-time moderate overweight has been almost erased by the outperformance of the sector**, since we did not adjust our own target weights.

The other characteristics of the portfolio also remain reasonably stable. Our holdings' expected earnings growth, as calculated internally with data from LSEG/IBES, is about 350bps above that of the index in 2026 and another 260 bps above in 2027. Long-term growth forecasts are also in our favor, together with revisions dynamics and valuations. The market's P/E ratio is back below 20 times forward earnings, but our selection's multiple is hardly above 16x.

We also note that, based on the financial community's current target prices, our holdings have an upside of about 25%. This is much more than a few months ago and, while some of this effect is obviously due to the market's decline and analysts failing to adjust their estimates yet to the new economic environment, we believe that part of it is meaningful. **Even in March, despite the rising uncertainty, a few of our companies raised their guidance or announced accretive acquisitions**, and analysts made adjustments accordingly.

The outlook: While everyone finally realizes that there is a lot less strategy than impulsivity in Washington's policy, the exact situation on the ground remains difficult to assess behind the parties' efforts to control information. This makes it difficult to take a clear-cut bet on the outcome.

It obviously remains difficult to know how things will evolve from now. Information about the situation in Iran is anything but transparent. The new "supreme guide" Mojtaba Khamenei, who was elected a week after his father's death, has not been seen, even in videos, since that time. Rumors circulated that he might have left the country, or been injured in the initial strikes, or even might be dead. In the last few days, Donald Trump repeatedly said that Washington was conducting talks with Tehran, and that significant progress had been made. However, **in the absence of any details about these mysterious contacts, it is impossible to know if these talks (assuming that they really take place) have any chance to lead somewhere**.

We wrote last month that there were three possibilities just after the initial strikes: a very short war, a conflict that would last longer and get bogged down, and the same with, in addition, a withdrawal of the USA from the conflict. The first option now looks unlikely and the other two, which we used to call "not unlikely" a month ago, now look very likely, with a growing probability for the latter. **Iran is fighting back and paralyzing most major economies in the world with a few missiles and plenty of cheap drones that can be mass-produced almost anywhere with 3D-printing**. On the other side, the US and Israel are obliged to deploy sophisticated interception solutions, that cost millions for each launch and do not even provide a 100% protection to their and their allies' assets in the region. There is no evidence that the strikes really accelerate the collapse of the Iranian regime. It is certainly tempting for Donald Trump, who probably knows he will not win this war, to claim that he has reached his objectives and walk away. He has key mid-term elections coming in a few months, his popularity is falling slowly but steadily, and he never hesitates to rewrite the truth when it doesn't suit him.

We therefore consider that the situation has worsened and that a positive outcome for global economies is becoming increasingly unlikely in the short-term. Our portfolio is slightly defensive, we might make a few adjustments as the situation evolves, but **we will probably not move very far away from the current stance in the near future**. This would be too risky, given the erratic way decisions are made and announced at the moment in Washington. We will therefore continue to focus our stock-picking criteria on visibility and execution quality. This approach may not save us from experiencing the market's bumps, but we know that, at least, it is the best way to emerge relatively unscathed in the medium- and long-term. This modestly defensive stance is also consistent with our view that, **while the whole world will be impacted if things don't get sorted swiftly, the US market is less vulnerable than most others**, because it is a lot less dependent on oil imports and the authorities will not hesitate to temporarily suspend regulations if the constraints they create become too detrimental.

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