UK Sustainable Equity strategy

BoE increased interest rates for the first time in more than three years

- Omicron concerns abated as cases less severe, reducing impact on economic growth
- GB implemented 'Work, When and Where you Want' policy, increasing job applications
- DiscoverIE have set a 50% carbon emissions reduction target by 2025

Nigel Yates
Portfolio Manager, UK Sustainable Strategy

What's happening?

Having started the month with a broad sell-off due to concerns over the Omicron variant of Covid, the market gradually came to the conclusion that this strain of the virus was highly transmissible but likely less dangerous, and thus less disruptive to economic growth. A more surprising development came in the middle of the month when the Bank of England (BoE) unexpectedly increased interest rates for the first time in more than three years. The BoE described the decision as finely balanced. The lack of clarity on whether Omicron would be inflationary or disinflationary seems to have swung the decision to hike, along with the BoE feeling under pressure from headline inflation which is forecast to peak in Spring 2022 at around or above 6%.

The UK equity markets managed the traditional 'santa rally' through the final month of 2021 and unlike much of the rest of the year where style, size and currency factors skewed performance, during December the market's advance was broadly spread. The FTSE All Share (+4.68%[1]), FTSE 100 (+4.75%[1]) and FTSE 250 (ex-Investment Companies, +4.95%[1]) all delivered positive returns, with the FTSE Small Cap (ex-Investment companies, +5.83%[1]) performing strongest of all. Over the 12 months, the FTSE 100 (+18.40%[1]) performed in-line with the FTSE 250 (ex-Investment Companies, +18.35%[1]), while the FTSE Small Cap (ex-Investment companies, +31.26%[1]) outperformed.

Portfolio positioning and performance

The strategy underperformed the FTSE All-Share Index in December as Rentokil pulled back following news that it is to acquire US peer Terminix for approximately US$6.7 billion. Whilst the deal makes strategic sense the size and unexpected nature of it caused investors to reduce their exposure to this long-term earnings compounder. Ceres Power continued to

[1] Source: Bloomberg

struggle as clean energy stocks remained out of favour with investors. The strategy's exposure to the technology sector and not owning tobacco companies detracted from relative performance.

On a positive note, there were many solid performances with the takeover approach for Clinigen and strong performances from Auction Technology Group, Diageo, Experian, Moonpig, TI Fluid Systems & WH Smith.

From an Environmental, Social & Governance (ESG) point of view it was pleasing to see during the month that GB Group were thinking progressively and implemented a 'Work, When and Where you Want' policy. Following this approach, they have received a threefold increase in job applications in what is currently a very tight labour market. DiscoverIE are also very engaged from an ESG point of view. They have set a 50% carbon emissions reduction target by 2025 and are making good progress to achieve this through efficiency savings and installation and purchase of renewable energy. In addition to this they have launched a supplier code of conduct, integrated diversity principles in hiring practices & improved health and safety reporting. Treatt Plc recently won the best company to work for in the East of England. 73% of their employees are shareholders and also boast a very good tenure record. Hollywood Bowl have also integrated sustainability targets into team member incentive schemes and installed solar panels on their roofs.

During the month an engagement meeting took place with 'in transition' company Genus. ESG analysis was undertaken on the following names: Genus, Kin & Carta, TI Fluid Systems & Treatt. The portfolio consists of 66% in companies that are deemed as ESG leaders and 34% that are 'in transition' and cash.

Outlook

Market direction in 2022 seems likely again to be shaped by Covid and inflation. Central banks performed a u-turn on inflation in 2021, shifting from a reassurance that it would be a "transitory" reflection of the post-lockdowns bounce back to an acceptance that it is more persistent. With expectations that inflation will peak in the spring, there is the chance that central bank policy mistakes could be made. Striking the right balance between slowing the economy as it recovers and not allowing it to overheat will be hard to achieve, especially while withdrawing other monetary support.

There are, of course, reasons to be optimistic about equities in 2022. Economists are forecasting that global real GDP growth will remain above trend. China is in a different phase of its interest rate cycle and government support for the economy is likely to be given through the year ahead. In addition, global inventory levels remain low and the process of rebuilding them will be a further tailwind through 2022. Earnings forecasts are modestly set and valuations should not be a barrier to further progress following the strong earnings growth in 2021 which brought some multiple compression.

Our approach remains centred on owning good quality businesses that can reinvest and compound their returns over time. We continue to believe that understanding longer term structural trends and identifying responsible, reliable and ultimately sustainable companies, in a targeted, focused and active approach, remains the key to longer-term success.

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