UK Sustainable Equity strategy

2022 started with a style rotation from growth to value

- Our approach remains centred on owning high quality businesses
- Sustainably run companies that we own have continued to report good earnings
- We added a new position in industrial and electronic parts company Electrocomponents

Nigel Yates
Portfolio Manager, UK Sustainable Strategy

What's happening?

2022 started with a sharp style rotation as 'growth companies' fell indiscriminately as a result of central banks changing their rhetoric on inflation from temporary to more entrenched. Expectations of interest rates rises resulted in 10-year Treasury yields rising from circa 0.5% at the low (August 2020) to 1.8% at the end of January 2022. This has led to investors purchasing 'old economy' companies in sectors that have historically provided inflation hedging such as oil and gas and banks and 'long duration' assets such as software and clean technology companies have been sold.

Inflation at its simplest level is generated by an imbalance of supply and demand. Covid has provided a myriad of micro economic events that have culminated in market distortions, leading to unpredictable supply of many goods and services. Demand on the other hand has bounced back dramatically in many areas, resulting in demand outstripping supply. It is logical to assume that over time, supply issues will ease. It is also possible that a slowing economy or inflation induced demand destruction will contribute to balanced supply and demand, thereby reducing inflationary pressures. It is also worth noting that US Treasuries are not forecast to rise above 2.5%. This remains at the low end of the range over the last 10 years, a time in which 'growth' stocks have performed well. Far from steepening (at the time of writing) the yield curve has flattened, perhaps telling us something opposite to what the 'value' rotation is making us believe. Rates are moving higher because central banks are increasing rate expectations in an attempt to control inflation rather than as a result of rampant economic growth.

When speaking to companies, we are certainly hearing of improving supply chain conditions. Wage inflation and second order effects may persist for longer and these effects will need to be monitored. However, the implications of a flattening yield curve and easing supply constraints may result in stock market participants moving away from focusing on cyclical, 'value' stocks to those that can grow their earnings over the long term.

When we look at businesses, we are interested in the ability of a company to give shareholders exposure to the power of compounding profitability and cash flows, where company management have proven competence and the balance sheet is sufficiently strong to support growth. The companies we own who have reported in January, Pets at Home, Experian, Marshalls, Gamma Communications and Dechra have all reported such characteristics but in some cases are up to 20% below the level they traded at on 31 December 2021. We remain alert to these sort of price moves and have been taking advantage. Many 'growth' stocks have compressed from a multiple perspective but their prospects continue to improve. In today's market environment, that is easy to dismiss but we firmly believe that opportunities are compelling and can provide strong returns over the longer term, even if short-term returns are volatile.

The stock market dynamics of 2022, have had profound short-term impact on the valuation ascribed to growth stocks. Given that the FTSE 100 is more exposed to value stocks than the FTSE 250 or FTSE Small Cap, the disparity of performance can be seen when the UK Indices are compared. The FTSE All Share (-0.3%)[1], FTSE 100 (+1.1%)[1], FTSE 250 (ex-Investment Trusts, -6.4%[1]) and the FTSE Small Cap (ex-Investment Trusts, -3.4%[1]).

Portfolio positioning and performance

Our conviction to high quality sustainable growth companies who are aligned to our target markets (defined by our People, Planet, Progress thematic lens) means that we are naturally underweight companies considered to be value and cyclical sectors and overweight technology, healthcare and industrials. This has meant short-term performance has deviated from the FTSE All Share, which is heavily represented (30%+) by cyclical and value sectors.

During January the strategy added to its position in Auction Technology Group, GB Group and Blancco Technology group (Progress theme – Connecting People). The January stock market sell off was most acute in the technology sector this month and valuations have fallen considerably in these companies, yet the prospects for material earnings growth remain undiminished. This was reinforced by the January trading update of Blancco (digital erasure specialist preventing e-waste) which highlighted 20% revenue growth and significant upgrades to market estimates.

We started a new position in Electrocomponents (Progress theme – Connecting People). Electrocomponents is one of the world's leading distributors of industrial and electronic parts with strong and improving responsible business practices. Their technology advantage, which they have been investing in over a numbers of years, could lead to accelerating growth as their digital advantage will be increasingly important post the pandemic and should enable them to take significant market share in a growing market. They also play a critical role in helping their customers be more sustainable through responsible sourcing, bringing the supply chain closer to customers and less carbon intensive delivery mechanisms.

The remaining position in Clinigen was sold following its takeover approach in December 2021 and some profits were taken in BP, SSE and Astrazeneca.

Outlook

As in January, market direction seems likely to be shaped by Covid and inflation. Inflation data seems likely to continue increasing in the first half of the year from already high levels and central banks are likely to continue their hard line on it. However, striking the right balance between controlling inflation and not slowing the economy as it recovers will be hard to achieve, especially while governments withdraw their fiscal 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. 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 are in many instances trading at multi-year lows.

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.

[1] Source: Bloomberg

No assurance can be given that the UK Sustainable Equity Strategy will be successful. Investors can lose some or all of their capital invested. The UK Sustainable Equity strategy is subject to risks including; Equity; Smaller companies risk; Liquidity risk; Investments in small and/or micro-capitalisation universe; Investments in specific countries or geographical zones.

Not for Retail distribution: This document is intended exclusively for Professional, Institutional, Qualified or Wholesale Clients / Investors only, as defined by applicable local laws and regulation. Circulation must be restricted accordingly.

Past performance is not a guide to current or future performance, and any performance or return data displayed does not take into account commissions and costs incurred when issuing or redeeming units. The value of investments, and the income from them, can fall as well as rise and investors may not get back the amount originally invested. Exchange-rate fluctuations may also affect the value of their investment. Due to this and the initial charge that is usually made, an investment is not usually suitable as a short term holding.

This document is for informational purposes only and does not constitute investment research or financial analysis relating to transactions in financial instruments as per MIF Directive (2014/65/EU), nor does it constitute on the part of AXA Investment Managers or its affiliated companies an offer to buy or sell any investments, products or services, and should not be considered as solicitation or investment, legal or tax advice, a recommendation for an investment strategy or a personalized recommendation to buy or sell securities. The strategies discussed in this document may not be available in your jurisdiction.

Due to its simplification, this document is partial and opinions, estimates and forecasts herein are subjective and subject to change without notice. There is no guarantee forecasts made will come to pass. Data, figures, declarations, analysis, predictions and other information in this document is provided based on our state of knowledge at the time of creation of this document. Whilst every care is taken, no representation or warranty (including liability towards third parties), express or implied, is made as to the accuracy, reliability or completeness of the information contained herein. Reliance upon information in this material is at the sole discretion of the recipient. This material does not contain sufficient information to support an investment decision.

Before making an investment, investors should read the relevant Prospectus and the Key Investor Information Document / scheme documents, which provide full product details including investment charges and risks. The information contained herein is not a substitute for those documents or for professional external advice. The products or strategies discussed in this document may not be registered nor available in your jurisdiction. Please check the countries of registration with the asset manager, or on the web site https://www.axa-im.com/en/registration-map, where a fund registration map is available. Please note that the management company reserves the right, at any time, to no longer market the product(s) mentioned in this communication in the European Union country by notification to its authority of supervision in accordance with European passport rules. In particular units of the funds may not be offered, sold or delivered to U.S. Persons within the meaning of Regulation S of the U.S. Securities Act of 1933. The tax treatment relating to the holding, acquisition or disposal of shares or units in the fund depends on each investor's tax status or treatment and may be subject to change. Any potential investor is strongly encouraged to seek advice from its own tax advisors. In the event of dissatisfaction with the products or services, you have the right to make a complaint either with the marketer or directly with the management company (more information on our complaints policy is available in English https://www.axa-im.com/important-information/comments-and-complaints). You also have the right to take legal or extra-judicial action at any time if you reside in one of the countries of the European Union. The European online dispute resolution platform allows you to enter a complaint form (https://ec.europa.eu/consumers/odr/main/index.cfm?event=main.home.chooseLanguage) and informs you, depending on your jurisdiction, about your means of redress (https://ec.europa.eu/consumers/odr/main/?event=main.adr.show2).

Issued in the UK by AXA Investment Managers UK Limited, which is authorised and regulated by the Financial Conduct Authority in the UK. Registered in England and Wales No: 01431068. Registered Office: 22 Bishopsgate, London EC2N 4BQ. In other jurisdictions, this document is issued by AXA Investment Managers SA's affiliates in those countries.