UK Sustainable Equity strategy

UK inflation hits 30-year high with CPI at 5.5% driven by Russia-Ukraine war

- Companies continue to report solid earnings updates such as Kin & Carta and Smith & Nephew
- Our holding Reckitt Benckiser has reached its 2030 target of reducing carbon by 65% in 2021
- We continue to own good quality businesses that reinvest and compound returns over time

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What's happening?

Equity markets started February on the back foot after a tough start to the year. Inflation and interest rate concerns and volatility picked up further as Russia launched a full-scale invasion of Ukraine. Oil prices spiked to a seven-year high, soaring to $105 a barrel[1] and gold prices jumped as investors rushed to safe-haven assets, with the precious metal hitting $1,970[1]. There was however positive UK GDP data over the month as Britain's economy continued its recovery from the Covid-19 pandemic, recording a smaller hit from the spread of the Omicron variant than feared. The data capped a turbulent two years that saw the collapse and then a rebound of the economy, growing 7.5% in 2021[1], the biggest annual rise since 1941.

The recent increase in interest rates has been justified by the inflation numbers in the UK, which reached a 30-year high in January as the Consumer Price Index hit 5.5%[1]. The Bank of England (BoE) has forecasted inflation will get as high as 7.5% in April. However, this does not factor in the recent spike in oil on the back of the Ukraine conflict. The BoE increased interest rates from 0.25% to 0.5% at the beginning of February and is expected to raise rates again in March[1].

The UK equity market provided quite divergent returns in February with the resource heavy FTSE 100 again holding up well in the face of a broader market sell-off. The FTSE All Share (-0.46%[1]) and FTSE 100 (+0.32%[1]) were the stronger performers, while the FTSE 250 (ex-Investment Companies, -3.98%[1]) and FTSE Small Cap (ex-Investment companies, -3.86%[1]) performed the weakest of all.

Portfolio positioning and performance

The strategy underperformed the FTSE All-Share Index in February due to its underweight position in industrial metals and mining and oil and gas, two sectors that have benefited from the recent high commodity prices. Technology holdings also continued to detract from performance despite generally reporting robust results. It should be noted that the strategy has minimal exposure to London-listed stocks with exposure to Russia and Ukraine.

[1] Source: Bloomberg

On a positive note, there were solid updates from Kin & Carta, Smith & Nephew, Reckitt Benckiser and Pets at Home. The underweight position to banks provided a relative source of positive performance as their results in general didn't meet their much anticipated expectations.

From an environmental, social & governance (ESG) perspective it was pleasing to see that Reckitt Benckiser have achieved their 2030 target of reducing carbon by 65% in 2021 and that nearly 30% of their revenue has been derived from more sustainable products. Rightmove have partnered with Generating Genius to encourage people from disadvantaged backgrounds to pursue a career in technology. Blancco highlighted that 80-90% of all electronic equipment is still being destroyed and dumped rather than securely erased and recycled. Surely a trend that needs to change? Pleasingly however, a quarter of all vehicles sold in December were fully battery powered.

In February we had an engagement meeting with Treatt PLC. An ESG analysis was undertaken on Auction Technology Group & Smith & Nephew. The portfolio consists of 68% in companies that are deemed as ESG leaders and 32% that are 'in transition' and cash.

During February the strategy added to its position in Auction Technology Group and NCC Group (both aligned to the Progress theme) as technology shares continued to struggle with the recent market rotation. We also added to fuel cell company Ceres Power (Planet – Clean Energy) following its JV announcement with Bosch and Weichai to expand commercial development in China, a key growth market for Ceres. The market sell-off also presented an interesting opportunity to purchase more Ashtead (Planet – Sustainable infrastructure), a rental provider with market leading positions in US, Canada & UK and a track record of market share gains and strong earnings growth. With sustainability in mind, they are helping the sharing economy and influencing the electrification of their fleet with manufacturers. To finance these purchases some profits were taken in BP, Convatec, Smith & Nephew and Astrazeneca which have performed relatively well in these volatile markets.

Outlook

Market direction continues to be shaped by inflation, interest rates and commodity prices. Inflation data seems likely to continue increasing in the first half of the year from already high levels, especially given the recent move in the oil price. The Russia-Ukraine conflict has however created tensions around the next interest rate rise. Striking the right balance between controlling inflation and not slowing the economy as it recovers is a tricky balancing act, especially while governments withdraw their fiscal support.

Despite the recent news flow, there are of course reasons to be optimistic about equities for the remainder of the year. 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.

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