UK Multi-Cap strategy

Market direction continues to be shaped by inflation, interest rates and commodity prices

- UK inflation hits 30-year high with CPI at 5.5% driven by Russia-Ukraine war
- UK stock market is home to numerous growing well managed businesses, generating cash
- Our approach remains centred on owning good quality businesses

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What's happening?

Equity markets started February on the back foot after a tough start to the year. Inflation, 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 and gold prices jumped as investors rushed to safe-haven assets, with the precious metal hitting $1,970 per ounce.

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, 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%. 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.

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 fell -0.46%[1], the FTSE 100 rose +0.32%[1] and the FTSE 250 (ex-Investment Companies) fell -3.98%[1], while the FTSE Small Cap (ex-Investment companies) fell -3.86%[1]. Note the fund remains underweight FTSE 100 stocks, in particular Banks, Miners, Tobacco and Consumer Staples.

[1] All the FTSE figures are sourced from Bloomberg, as of 28/02/2022.

Portfolio positioning and performance

Over the month, the strategy underperformed the FTSE All-Share. From a sector perspective, the underweight position in Financials contributed positively to relative performance. The overweight position in Industrials and underweight in Basic Materials detracted to relative performance.

Positions which contributed positively over the month included Chemring (defence), Antofagasta (copper mining) and Serica (oil & gas). Serica benefitted from the significant increases in wholesale gas prices over the month. In addition, Darktrace and Chemring both benefitted from heightened sensitivity to the threat of Cyber terrorism and increasing Geo-political risk. Future (specialty media) detracted from performance, as did not owning Shell, Glencore, Anglo American or Rio Tinto. The rotation out of 'growth' investments into 'value' has been detrimental to performance and this goes some way to explaining the fall in the share price of Future. The fundamentals of the business remain intact and we continue to support the investment case.

Our strategy and investment philosophy remained unchanged in February. We continue to focus on well capitalised companies that have growing profits, cash flows and, where appropriate, dividends. Market volatility was used to add to and reduce core holdings. Over the month, new holdings were taken in Shell and Standard Chartered.

Outlook

Market direction continues to be shaped by inflation, interest rates and commodity prices. Inflation seems likely to increase further in the first half of the year from already high levels, particularly given the recent move in the oil price. The Russia-Ukraine conflict has however created incremental debate around the path of interest rates and Quantitative Tightening by Central Banks. Striking the right balance between controlling inflation and stimulating the economy will be a tricky balancing act, especially while governments withdraw their fiscal support.

At times of heightened risk and uncertainty, it is easy to focus exclusively on the macro and geopolitical newsflow and lose focus on the fundamental drivers of profitability and cashflow at the corporate level. The UK stock market is home to numerous growing businesses that generate cash, are well managed, have strong balance sheets and are operating in end markets that should expand over the long term. 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.

No assurance can be given that the UK Multi-Cap Strategy will be successful. Investors can lose some or all of their capital invested. The UK Multi-Cap 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.

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