UK Sustainable Equity strategy

Striking the balance between controlling inflation and not slowing the economy will remain a tricky balancing act

- Profits were taken in Diageo, SSE, Rentokil and GlaxoSmithKline which have performed well
- Hollywood Bowl committed to 33% of its electricity being self-produced by the end of 2022
- We engaged with RWS, Just Group and Gamma Communications over the month

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What's happening?

The UK equity market has endured a higher than expected inflation print and subsequent tough central bank talk on interest rate expectations, GDP growth that slightly disappointed and the continued repercussions from the war in Ukraine. Given this backdrop, equities have been relatively resilient thanks in part to oversold conditions, solid trading updates and further M&A interest, although the performance is increasingly skewed to a smaller number of winners.

April can be categorised again as another period where fairly solid earnings were met with investors questioning the right valuation metrics to pay for businesses in this current environment, and in particular growth businesses. Private equity however is showing more optimism and there was an expression of interest in RWS by Baring Private Equity Asia which had reached very oversold territory. Homeserve also confirmed they were in talks with Brookfield Infrastructure although no deal has been reached yet.

In corporate news, Trainline was boosted by a commission review outcome that was more favourable than the market was expecting. There were also solid updates from Smith & Nephew, Hollywood Bowl, GB Group, Rentokil, London Stock Exchange and Astrazeneca. Aveva however warned that it was planning to invest more behind its growth opportunity and speed up its transition to the Cloud. XP Power lost a trade secret misappropriation case leading both shares to underperform.

The commodity price spike has meant continued outperformance of sectors such as industrial metals, mining and oil and gas. In addition, a combination of solid results and fears around the outlook for growth have led defensive sectors to outperform such as tobacco, pharmaceuticals and utilities. This can be seen in the UK equity market returns for April which show the resource heavy FTSE 100 outperforming the broader market. The FTSE All Share (+0.31%)[1], FTSE 100 (+0.76%)[1] and FTSE 250 (ex-Investment Companies, -1.48%)[1], while the FTSE Small Cap (ex-Investment companies, -0.88%)[1].

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[1] Source: Bloomberg, local currencies as at 30/04/2022.

Portfolio positioning and performance

During April the strategy added to its position in RWS Holdings (Progress theme) which continues to look good value even after its small bounce following an indication of interest from a private equity firm.

The strategy also consolidated its progress theme holdings by selling its position in Sage and using the proceeds to purchase more Auction Technology Group, GB Group, Kainos & Gamma Communications. The valuation of Sage has held up well compared to these other holdings in the technology sell off but the prospects for future growth are not considered as high. Profits were also taken in Diageo, SSE, Rentokil and GlaxoSmithKline which have performed relatively well in these volatile markets. An IBM survey, which includes responses from over 16,000 people in 10 countries, highlighted that potential employees are increasingly likely to apply for and accept jobs from companies they view as environmentally sustainable. This highlights the importance and competitive advantage afforded to companies that have progressive views on their environmental and social impact.

Finally, Hollywood Bowl reported that by the end of 2022, 15 centres would have installed solar panels on their roofs which will result in up to 33% of the sites required electricity being self-produced.

During the month engagement meetings and ESG analysis were undertaken with RWS, Just Group & Gamma Communications. The portfolio consists of 74% in companies that are deemed as ESG leaders and 26% that are 'in transition' and cash. This is a notable increase from the previous month and highlights the improved MSCI scores attributed to a number of our holdings.

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, 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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