For professional clients only
June 2022
Monthly Perspectives
AXA IM Equity

UK Multi-Cap strategy

UK companies with earnings from international economies outperformed those with revenue from UK economy

- Equity market volatility continued in June with negative market sentiment
- Market continues to be shaped by inflation, interest rates and commodity prices
- Over the month we sold our holdings in On the Beach and Boohoo

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What's happening?

Equity market volatility continued in June as inflation, the rising cost of living, the upward interest rate cycle and the war in Ukraine all contributed to negative market sentiment.

To date, much of the reduction in equity prices has been attributed to the rise in the cost of debt. As interest rates have risen, the discount rate applied to future earnings has increased, thereby reducing the Net Present Value of those cash flows. This has resulted in a 'de-rating' of many equities. Over June, investors focussed increasingly on the impact of rising interest rates on macro-economic growth. Central bank action is slowing economic growth and the risks of a recession are rising – demand destruction, the antidote to inflation appears to be evident. Given the deteriorating macro-economic backdrop, the risk of a central bank policy error was brought sharply into focus over the month as the Federal Reserve in the US increased rates by 0.75% and the Bank of England also raised again with promises of more.

In the UK, political turmoil and slowing economic growth (versus the US in particular) contributed to sterling weakness versus the US dollar. This helped contribute to the outperformance of UK listed companies with earnings from international economies rather than the UK economy, favouring the 'mega cap' companies of the FTSE100.

Given this backdrop, global and UK equity markets struggled. Large companies, represented by the FTSE 100 index, outperformed smaller market capitalisation companies over the month. The FTSE All Share (-5.98%), FTSE 100 (-5.53%), & FTSE 250 (ex-Investment Companies, -9.62%), while the FTSE Small Cap (ex-Investment companies, -7.98%).

The strategy of the fund remains focused on high quality companies across the market capitalisation spectrum of the FTSE All Share with structural growth, strong balance sheets and excellent management teams.

Portfolio positioning and performance

Over the month of June, the strategy underperformed the FTSE All-Share. From a sector perspective, the underweight position in basic materials (mining) was the largest positive contributor. Consumer discretionary and technology were the largest negative contributors to relative performance.

Positive stock contributors over the month included iEnergizer (Industrials), Melrose (Industrials), Serica (oil and gas) and Spirent (Telecommunications). Not holding Anglo American, Glencore and Rio Tinto was also beneficial from a relative perspective. Detractors from performance included GB Group (technology), Essentra (Industrials), Revolution Beauty (Consumer Discretionary) and Darktrace (technology). Not owning HSBC and British American Tobacco detracted.

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, the holding in On The Beach and Boohoo were sold.

Outlook

Market direction continues to be shaped by inflation, interest rates and commodity prices. We continue to meet with company management teams and are reassured by generally strong results and cautiously optimistic guidance. Pockets of inflationary pressures remain and will need to be managed by companies; however anecdotal evidence suggests that wage inflation in particular is easing despite pockets of trade union activism. In addition, many commodities have started to 'roll over' as the expectations of declining economic output starts to impact. The expected peak in interest rates has started to decline and if sustained, our style of investing could become more in favour.

Central banks are continuing their fight against supply side induced inflation despite declining economic data. Striking the right balance between controlling inflation and not slowing the economy too much is a tricky balancing act.

At times of heightened risk and uncertainty, it is easy to focus exclusively on the macro and geopolitical news flow and lose focus on the fundamental drivers of profitability and cashflow at the corporate level. 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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