UK Sustainable Equity strategy

Mostly positive earnings updates combined with more dovish central bank messaging helped lift global equity markets

- Intermediate Capital Group has acquired British Solar Renewables
- Trainline beat forecasts with shift to digital ticketing and European rail travel beating expectations
- Solid earnings updates from Experian, RS Group, GB Group, Weir, SSE, Rentokil, Croda & Rightmove

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What's happening?

Markets enjoyed their best month of 2022 in July after investor sentiment levels had dropped to extreme lows. Generally positive earnings updates combined with central bank messaging, that was seen as being more dovish in tone helped lift equity markets globally.

In a shift to the investor mindset, bad news during the month was seen as good news given its implication for fewer interest rate hikes. July saw the first monthly drop in 10-year gilt yields since November 2021. This put a floor to the mechanical derating of equities, especially growth stocks, and led investors to 'just' worry about the economy and its potential impact on company earnings.

Purchasing Managers' Index (PMI) surveys released in July disappointed, while inflation continued to soar to new multi-decade highs. Concerns also arose around Russia shutting off the supply of gas to Europe, while the broader implications of a troubled Chinese real estate sector added further worries. Concurrently, US interest rates were increased by 75 basis points for the second consecutive meeting with the market expecting that the UK will see a further 50 basis point increase at its Monetary Policy Committee meeting in August. Also in the UK, the resignation of Prime Minister Boris Johnson triggered a race within the Conservative Party to become the new leader. The winner is set to be announced on 5 September 2022.

In the UK, the FTSE All Share (+4.36%)[1] and its constituent parts, the FTSE 100 (+3.67%)[1], FTSE 250 (ex-Investment Companies, +9.13%)[1] and the FTSE Small Cap (ex-Investment companies, +3.50%)[1] all recovered some of the recently lost ground. Year-to-date returns for the FTSE All Share Index are almost flat (-0.41%)[1] however the divergence of performance between the FTSE 100 (+2.66%)[1] and the mid and small cap indices mentioned (-13.38% and -13.48% respectively) [1] remains pronounced.

[1] Source: Local Currencies, Bloomberg as at 31/07/2022.

Portfolio positioning and performance

In corporate news, sentiment towards Trainline has shifted dramatically as regulatory clouds have dissipated in recent months. Their update in July trumped forecasts with the shift to digital ticketing and European rail travel beating expectations. There were also solid updates from Experian, RS Group, GB Group, Weir, SSE, Rentokil, Croda and Rightmove. However, Smith & Nephew did indeed suffer from Chinese lockdowns along with continued supply chain issues. Aveva's 11% sales growth was also seen to be disappointing by the market. The medium to long-term prospects for both these businesses is still felt to be attractive.

From an Environmental, Social & Governance (ESG) point of view it is pleasing to note that Intermediate Capital Group has acquired British Solar Renewables, one of the largest integrated solar developers in the UK. During the month ESG analysis was undertaken on Genuit and Pets at Home. The portfolio consists of 77% in companies that are deemed as ESG leaders and 23% that are 'in transition' and cash.

As the markets rallied some profits were taken in Smith & Nephew ahead of their results given fears around what the impact of Chinese lockdowns may have had on their short term performance. TI Fluids was also sold from the portfolio given their continued supply chain issues and the potential impact that deteriorating economic fundamentals could have on their earnings.

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 and supply chain 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.

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 as it recovers 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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