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UK Mid Cap strategy

Material fiscal support planned to protect UK consumer from the unaffordable energy price rises

- After a brighter month in July, global equity markets fell in August
- Darktrace, 4Imprint, Energean and RS Group contributed positively
- Well capitalised and well managed companies continue to reside on the UK market

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What's happening?

After a brighter month in July, global equity markets fell in August, in what is usually a month of low liquidity and insipid returns. As inflation continued to rise, global central banks confirmed they remain committed to aggressively tightening monetary policy. Until inflation and interest rates peak, it is difficult to see financial assets making persistent headway.

The main focus in Europe continues to be the availability and price of wholesale gas, the rising cost of electricity and food price inflation. Although these issues appear to be pushing the crisis in Ukraine off the front pages of the newspapers, they are causally entwined.

Over the month, UK inflation hit another milestone, exceeding double digits as the Consumer Price Index (CPI) rate of inflation hit 10.1%. In an attempt to rein in inflation, the Bank of England raised base rates by 0.5% (its sixth straight raise) to 1.75%.

Recent UK macro-economic newsflow has been unrelentingly negative and this has taken its toll on UK sterling with the rate versus the US dollar at a 35 year low. Many commentators, including the Bank of England are now forecasting a recession in the UK. Whilst this feels inevitable, the depth and length of any recession will be crucial. In this environment, the outperformance of the more internationally focussed FTSE100 versus the more domestically focussed FTSE 250 continued.

Portfolio positioning and performance

In a volatile and unpredictable month, the strategy underperformed the FTSE 250 Excluding investment Trusts index. From a sector perspective, the underweight in Financials and overweight in Industrials was negative, whereas the overweight positions in Energy and Technology was positive.

Detractors from performance included Revolution Beauty (consumer Discretionary) which put a statement out to the stock market lowering profit guidance and highlighting issues raised by its auditor. The shares in Revolution Beauty have been

sold. Other detractors of note include Ascential (Technology), Hill and Smith (Industrial) and Marshalls (Industrial). We remain supportive of these investments and continue to monitor their operational performance closely. Positive stock contributors over the month include positions in Darktrace (Technology) which reported a preliminary take over approach from Thoma Bravo, 4Imprint (Consumer Discretionary), Energean (Energy) and RS Group (Industrials).

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, we sold the holdings in XP Power, Boohoo and Revolution Beauty. A new holding was taken in JTC.

Outlook

At the time of writing, the prolonged process of electing a new conservative party leader and Prime Minister has finished, with Liz Truss achieving a slimmer majority than predicted. Leaked reports suggest that material fiscal support (some reports suggest up to £140bn) is planned in order to protect the UK consumer from the unaffordable energy price rises implied by the wholesale gas price. If this becomes a reality, it will potentially reduce UK inflation and could mean that UK inflation has peaked. Global supply chains are easing, the price of West Texas Intermediate crude oil has fallen back to circa \$85 from circa \$125 (just after Russia's invasion of Ukraine) and the cost of moving freight from Asia to the West Coast of the US is down 70% from its peak. Wage inflation remains stubborn and it remains to be seen whether the balance of power moves demonstrably from the employee to the employer as the economy slows.

UK equities, in many parts of the UK stock market, have priced in a very poor economic outlook. This may transpire, yet innovative, well capitalised and well managed companies continue to reside on the UK market that will increase their market share through this economic cycle and will, in time, enjoy materially higher valuations. This combination of factors, together with weak sterling relative to the US dollar, is catalysing more take over approaches of UK companies. This will continue and illustrates the opportunity available for investors with a rational investment horizon, driven by fundamentals and not short term hysteria.

We remain focused on UK and internationally exposed businesses, where the fundamental profit drivers remain entrenched and equity holders benefit from the capital allocated and risks taken by management. We continue to believe that a rewarding strategy is to actively invest in UK-listed companies that are compounding their earnings and dividends, where corporate governance is world leading, where contract law and title law are dependable, and where company management teams are permanently accessible.

No assurance can be given that the UK Mid Cap Strategy will be successful. Investors can lose some or all of their capital invested. The UK Mid Cap strategy is subject to risks including; Equity; Smaller companies risk; Liquidity risk.

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