UK Sustainable Equity strategy

Base effects should see year over year inflation readings fall sharply, especially in the second half of this year

- Ashtead and DiscoverIE continued to report robust results
- Engagement meetings took place with Trainline, SSE & Croda
- Dechra Pharmaceuticals received a cash bid from EQT

Nigel Yates
Portfolio Manager, UK Sustainable Strategy

What's happening?

June rounded off a soggy quarter for the UK market. Over that period the FTSE 100 (-0.3%[1]) and the FTSE 250 (-1.7%[1]) gave back some of the market's first half gains, while the FTSE Small Cap (ex-Investment Companies) managed to rise 2.4%[1]. An unhelpful sector mix and the impact of a firmer Sterling on overseas earners weighed on the FTSE 100 in June and then the Bank of England's 50bps increase in UK interest rates hit many companies in the Mid Cap index hard especially those linked to housing or construction.

Looking back at the first half of 2023, most market commentators have been caught out by the persistent inflation in the UK economy and the relative robustness of economic growth. This combination has seen interest rates rise to 5% alongside a view that they might need to go higher still and be kept there for longer than originally anticipated. This has impacted gilt yields which in turn has weighed on UK equities. The lagged effects of the significant rate rises over the last 12 - 18 months are now being felt across the financial system. Central banks have been clear in their distinction between price and financial stability, continuing to raise rates as inflation remains well above target, however base effects should see year over year readings fall sharply especially in the second half of this year.

Portfolio positioning and performance

The strategy underperformed the FTSE All Share in June. In corporate news, there was plenty of positive updates with Ashtead once again announcing strong full year results and DiscoverIE bolstering its medium-term margin expectations. RWS announced a £50m buyback to signal confidence in their future prospects despite a period of challenged growth. NCC met recently downgraded analyst expectations but showed good progress in their restructuring to a higher margin more resilient business model.

Other companies to report solid results during the period were Safestore and Moonpig. Dechra Pharmaceutical recommended a cash bid of £38.75 per share from EQT. However, GB Group suffered further share price weakness despite an 'in line' set of results as higher interest and tax costs led analysts to downgrade their 2024 numbers again. Following a meeting with the company and Chairman we remain long term supporters of this business.

[1] Source: FactSet as at 30/06/2023

From an Environmental, Social & Governance (ESG) point of view it is pleasing to note that AstraZeneca announced a commitment to plant 200 million trees by 2030. During our ESG analysis biodiversity often does not feature as a corporate priority. The company also announced that it is on track to reduce greenhouse gas emissions (GHGs) from its operations and fleet by 98% by 2026 and halve its entire value chain footprint by 2030, on the way to a 90% absolute emissions reduction and becoming science-based net zero by 2045 at the latest.

ESG analysis was conducted on Accesso and Trainline during the month with both companies impressing on both 'what they do' and 'how they do it'. An engagement meeting also took place with Trainline PLC to discuss remuneration and their sustainability disclosures. Additional meetings also took place with SSE following the release of their Net Zero Plus strategy and with Croda to discuss sustainable sourcing, palm oil traceability and increasing their bio-based inputs.

The portfolio consists of 78% in companies that are deemed as ESG leaders and 22% that are 'in transition' and cash.

Selectively added to the existing position in GB Group (Progress) following the adverse share price reaction to an inline set of results and a reassuring company meeting. The position in Dechra Pharmaceuticals (People) continues to be trimmed following an agreed takeover approach by EQT.

Outlook

The main driver of equity markets is still the action in the world's bond markets. After the initial strong start to 2023 markets have reversed expectations that Central Banks would quickly pivot and have now realigned closer to the guidance of rates being higher for longer with the much hoped for rate tightening cycle end delayed once again. Market volatility will remain in the near-term as central bankers move into a new data dependant framework and investors will pay close attention to the immediate data releases along with the next central bank meeting now in August.

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.

Examples are provided for informational purposes only and should not be considered as solicitation or investment, legal or tax advice, a recommendation for an investment strategy or a personalised recommendation to buy or sell securities.

No assurance can be given that the UK Sustainable Strategy will be successful. Investors can lose some or all of their capital invested. The UK Sustainable Strategy is subject to risks including: Emerging markets; ESG; Global Investments; Impact; Investments in small capitalisation and/or micro capitalisation universe and Investment in specific sectors or asset classes.