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UK Mid Cap strategy

The start of a phased easing of lockdown restrictions boosted optimism

- UK equities moved higher in March
- UK stock market continues to offer multinational & domestic investment opportunities
- Short-term inflation remains topical, long-term structural drivers remain undiminished

Chris St John

Portfolio Manager, UK Mid Cap Strategy

What's happening?

UK equities moved higher in March. The speed of the COVID-19 vaccination program in the UK and the start of a phased easing of lockdown restrictions boosted optimism about an economic rebound. Investors also largely welcomed the Chancellor's annual budget, which included an extension of the government's wage support scheme until at least September of this year. Broader market gains were mostly driven by a continuation of the rotation from growth into value names.

A third wave of COVID-19 infections across Europe led to concerns about the pandemic at a global level, as many countries were forced to reintroduce lockdown measures.

Portfolio positioning and performance

The strategy has performed positively in March in absolute terms, however it has lagged its comparative benchmark, the FTSE 250 (ex-Investment Trusts) Index. From a sector perspective, the strategy benefitted from being underweight the technology sector, although stock selection within this sector dragged on performance. Stock selection within basic materials, owning Hill & Smith (an international group of companies operating within the infrastructure and galvanizing markets) and Bodycote (a provider of thermal processing services), and financials contributed positively to performance.

Hill & Smith announced an increase in their dividend and a positive outlook, reinforcing that there are positive dynamics in their key end markets, given growing expectations of infrastructure investment. Bodycote reiterated a similarly positive message when they announced 2020 results. They too increased their dividend.

Other positive stock contributions of note included Restaurant Group (who owns chain of restaurants and public houses in the UK) and Bellway (a residential property developer and housebuilder). Recent steps taken by the management team at Restaurant Group to recapitalise and reposition the business position it for growth once pubs and restaurants can reopen. Detractors on a relative basis included The Hut Group and Learning Technologies.

We used share price volatility to add to core holdings and make reductions. We took a new holding in Royal Mail and sold our position in Genus.

Outlook

Inflation may be topical, however the many secular thematic areas that form part of our investment process have not diminished. The internet, accelerated by COVID-19 in many cases, will become more pervasive in all areas of our lives, rapidly growing demand for data manipulation, storage and transfer will not cease, individuals will still get older, and human beings will remain social creatures.

The UK stock market continues to offer both multinational and domestic UK-focused investment opportunities, exposed to the many themes available to US and other international stock markets. The significant amounts of recent M&A¹ activity suggests that corporate and private equity buyers are willing and able to take advantage of the many opportunities on the UK stock market. Given the ongoing spread between the cost of debt and the earnings yield of UK businesses, combined with their prospects, we continue to believe that UK-listed companies will continue to be targeted.

Looking ahead, the path to economic growth will be determined by the speed and success of the vaccine rollout on a global basis. Inevitably, the trajectory of economic growth, inflation, currency movements, and the cost and availability of capital will prove unpredictable, at least on a short-term basis.

In these times of volatile news and capital flow, we continue to focus on those companies that we believe can compound their earnings, and where balance sheet strength is supportive of that growth.

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.

¹ M&A: Mergers and Acquisitions

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