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UK Mid Cap strategy

Evidence from companies that supply chains are starting to ease

- UK GDP forecasts ahead of market expectations
- Bank of England remains ready to react to inflationary pressures
- We added a new position in Synthomer

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What's happening?

October was once again dominated by macroeconomic and geopolitical news flow. The UK Chancellor's budget revealed UK GDP¹ forecasts ahead of market expectations, as well as a reduction in government borrowing projections. The budget itself was more expansionary than expected, contrasting with the announcement of tax rises earlier in the year. Combined with ongoing news flow around supply chain disruption, demand/supply imbalances and widespread inflationary pressures, the short-term backdrop suggests that the cost of borrowing should rise.

The Bank of England remains ready to react to inflationary pressures but to date has kept base rates on hold, to the surprise of market participants. Generally speaking, however, global central banks appear inclined to reduce their support as both economic growth and inflation expectations rise.

From an equity perspective, large caps in aggregate outperformed the more UK domestically focussed mid-caps over the month. The FTSE 100 (+2.2%²) outperformed the FTSE 250 (ex-Investment Companies, -0.2%²), while the FTSE Small Cap (ex-Investment companies, -1.2%²) weakened somewhat.

¹ GDP: Gross Domestic Product

² Source: Bloomberg, 31/10/2021

Portfolio positioning and performance

The strategy slightly underperformed the FTSE 250 ex IT in October. Quality and growth factors started the month weaker than value, performing better towards the second half of the month. From a sector perspective, the underweight to the real estate and utilities sectors contributed negatively to performance. Stock selection within the technology sector proved positive, with Darktrace (a cybersecurity company), Auction Technology (provides marketplaces and a proprietary auction platform for curated auctions) and Bytes Technology (a provider of software, security and cloud services) adding positively to relative performance.

Positive stock performances of note included Synairgen (a drug discovery and development company), Watches of Switzerland (a luxury watch retailer) and Safestore (a provider of self-storage). Synairgen's share price rose on news that its inhaled Covid treatment will progress to phase 3 of US government sponsored trials. The drug has been highlighted as a promising COVID-19 treatment, with growing evidence to support the rationale of delivering a drug directly to the lungs.

Detractors over the month include On the Beach and boohoo. Not holding Playtech also contributed negatively.

We used share price volatility to add to core holdings and make reductions. A new position in Synthomer, a chemicals company, was taken in the month as part of a fund raising to acquire Eastman's Adhesive Resins business. The acquisition increases the scale and competitive position of its existing specialty portfolio.

Outlook

Given the macroeconomic news flow, the equity market is being influenced to some degree by movements in global bond markets. Debate around the likely duration and extent of inflationary pressures continue to dominate and the UK consumer has seen the impact of supply/demand imbalances in many areas of their lives, including on petrol forecourts and via news headlines around impending utility bill inflation. Although the commentary is unrelentingly inflationary, we are starting to see emerging evidence from companies that supply chains are starting to ease. Increasing supply or demand destruction? Equilibrium would be welcomed by companies and should contribute increasingly to the 'inflation is transitory' narrative.

In this environment, 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.

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