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May 2022
Monthly Perspectives
AXA IM Equity

UK Sustainable Equity strategy

2022 renewable power capacity set for record growth as 320GW of new capacity to be added

- Markets continue to be worried about the potential pace of rate rises over the coming year
- BP commits to the UK investing up to £18bn in the UK's energy system by end of 2030
- The strategy has 76% of companies that are 'ESG leaders' and 24% that are 'in transition'

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What's happening?

Equity market volatility continued in May. The challenging start to 2022 continued with inflation, the rising cost of living, the upward interest rate cycle, Chinese economic weakness and the war in Ukraine all contributing to negative market sentiment.

Concerns continue to build around the risk of an economic slowdown with consumer spending likely curtailed as a result of higher energy prices meaning less scope for discretionary spend. In early May both the Bank of England and the US Federal Reserve hiked interest rates. Markets continue to be worried about the potential pace of rate rises over the coming year, particularly in the face of seemingly softening economic outlooks. However, governments are sensitive to the pressures that the consumer is under. In the UK, the Chancellor announced a windfall tax on energy company profits to fund a new package of support to help with the cost of living crisis.

The consumer discretionary sector performed well in May after a particularly weak performance since the start of the year. Large companies, represented by the FTSE 100 Index, outperformed smaller market capitalisation companies significantly over the month. The FTSE All Share (+0.70%)[1], FTSE 100 (+1.13%)[1], & FTSE 250 (ex-Investment Companies, -0.72%)[1], while the FTSE Small Cap (ex-Investment companies, -1.92%)[1].

Portfolio positioning and performance

Within our People theme, the holding in Homeserve was sold in May following news the company would be acquired by Brookfield Asset Management, with the deal expected to complete at the end of this year. The strategy increased its holding in Treatt, Accesso Technology, Genus and Ashtead as we sought to take advantage of share price weakness. Profits were taken in AstraZeneca, Legal & General and Just Group, which have performed relatively well in these volatile markets.

In corporate news, the CEO of Rightmove announced he was stepping down after a 16 year tenure. Experian acquired a leading Brazilian fintech to accelerate the company's growth in the region. There were also solid updates

[1] Source: Bloomberg, local currencies as at 31/05/2022.

from Trainline, Grainger, Pets at Home, Experian, NCC Group, Kainos and Auction Technology. Marshalls highlighted that Easter saw a slowing of their domestic business due to installer holidays which was taken poorly by the market and RWS fell after a potential bid for the company didn't materialise. May was also a very strong month for commodity related shares which the strategy has limited exposure to given their cyclical nature.

From an Environmental, Social & Governance (ESG) point of view it is pleasing that according to the International Energy Agency (IEA) the world added record renewable power capacity in 2021 and 2022 is set for another year of record growth as 320GW of new capacity is expected to be added. Within the portfolio key enablers in this are SSE, Ceres Power, DiscoverIE and not to forget BP which intends to invest up to £18bn in the UK's energy system by the end of 2030, demonstrating their commitment to the UK.

Grainger committed to offering support for Ukrainian refugees through providing free accommodation through the Homes for Ukraine scheme. They have also adopted a multi-year programme of communications 'Living a Greener Life' to help educate and encourage their customers toward greener living.

During the month ESG analysis was undertaken with Oxford Nanopore & RS Group following the release of their annual reports. The strategy consists of 76% in companies that are deemed as ESG leaders and 24% that are 'in transition' and cash.

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 pressures remain and will need to be managed by companies; however anecdotal evidence suggests that wage inflation in particular is easing. The Russia-Ukraine conflict has added to complications around the timing of future interest rate rises. Striking the right balance between controlling inflation and not slowing the economy as it recovers is a tricky balancing act, especially while governments withdraw their fiscal support.

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. The UK stock market is home to numerous growing businesses that generate cash, are well managed, have strong balance sheets and are operating in end markets that should expand over the long term. Earnings forecasts are set modestly, and valuations look attractive, in many instances trading at multi-year lows. Attractive valuations have meant M&A has continued to be a feature in the UK market. Another indication of this is the current increase in insider buying of shares. It's difficult to argue that any good news is likely to see the market react positively, whether it be a resolution to the Ukraine conflict, inflation rolling over or central banks reining in interest rate hikes.

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.

[1] Source: Bloomberg, local currencies as at 31/05/2022.

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[1] Source: Bloomberg, local currencies as at 31/05/2022.