UK Mid Cap strategy

Markets enjoyed their best month of 2022 in July after investor sentiment levels had dropped to extreme lows

- July saw the first monthly drop in 10yr gilt yields since November 2021
- Companies results announced during the period were broadly positive
- Many companies are dealing well with global externalities

Chris St John
Portfolio Manager, UK Mid Cap Strategy

What's happening?

Markets enjoyed their best month of 2022 in July after investor sentiment levels had dropped to extreme lows. Generally positive earnings updates combined with central bank messaging, that was seen as being more dovish in tone helped lift equity markets globally.

In a shift to the investor mindset, bad news during the month was seen as good news given its implication for fewer interest rate hikes. July saw the first monthly drop in 10yr gilt yields since November 2021. This put a floor to the mechanical derating of equities, especially growth stocks, and led investors to 'just' worry about the economy and its potential impact on company earnings.

Purchasing Managers' Index (PMI) surveys released in July disappointed, while inflation continued to soar to new multi-decade highs. Concerns also arose around Russia shutting off the supply of gas to Europe, while the broader implications of a troubled Chinese real estate sector added further worries. Concurrently, US interest rates were increased by 75 basis points for the second consecutive meeting with the market expecting that the UK will see a further 50 basis point increase at its MPC meeting in August. Also in the UK, the resignation of Prime Minister Boris Johnson triggered a race within the Conservative Party to become the new leader. The winner is set to be announced on 5th September 2022.

In the UK, the FTSE All Share (+4.36%) and its constituent parts, the FTSE 100 (+3.67%), FTSE 250 (ex-Investment Companies, +9.13%) and the FTSE Small Cap (ex-Investment companies, +3.50%) all recovered some of the recently lost ground. Year to date returns for the FTSE All Share Index are almost flat (-0.41%) however the divergence of performance between the FTSE 100 (+2.66%) and the Mid and Small cap indices mentioned (-13.38% and -13.48% respectively) remains pronounced.

Portfolio positioning and performance

The strategy performed positively in absolute terms and in line with its comparative benchmark, the FTSE 250 ex Investment Trusts, over the month. From a sector perspective, the overweight in the industrials and technology sectors, and underweight in financials contributed positively to performance. The overweight to energy was a drag on performance.

Positive stock contributors over the month include positions in Serica Energy (gas & oil), 4imprint (produces promotional products) and Ashtead (international equipment rental company). Serica received a bid approach from Kistos and subsequently made an offer of its own to buy Kistos. Not holding Direct Line Insurance, impacted negatively by inflation within the car insurance sector, was positive from a relative performance perspective. Detractors from performance include Revolution Beauty (personal care products) and Rathbones (investment management services).

In corporate news, results announced during the period were broadly positive including solid updates from RS Group, GB Group, Breedon and Rentokil.

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 holdings in Aveva, Molten Ventures and Synthomer.

Outlook

Equity market direction is likely to be influenced by macro-economic and geopolitical events and commentary. The interplay between the war in Ukraine, inflation, interest rates and slowing economic output will inevitably influence capital flows and both equity and debt markets are likely to remain volatile under these circumstances.

Over the ongoing reporting season, company management teams are updating on both current trading and their outlook, which is offering a real time perspective of trading conditions across industry and geography. Many companies are dealing with the aforementioned externalities well and as yet are not seeing symptoms of slowing end markets. Share prices have fallen materially in many cases, reflecting an anticipated collapse in economic growth. The indiscriminate nature of many of these falls is providing opportunity and the positive equity returns seen over July are perhaps a sign that equity values in the UK have fallen too far.

We continue to expect UK companies to be targeted by acquirers, particularly given the appreciation of the US dollar versus UK Sterling. We remain focussed on companies that are growing and compounding their earnings and cashflows, are well managed 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.