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Rathbones
Look forward

Rathbone UK Opportunities Fund

Update, February 2019

There was no let up in the whipsaw market last month with stocks continuing to bounce in February. This rally was mainly about re-rating rather than a pick up in earnings growth (although by and large recent results have been pretty positive). Domestic names were to the fore; to us, it looked like investors returning to UK stocks after a long absence. Allocations to the UK are still very low, but we're hoping this improving trend will continue.

Your fund underperformed, rising 0.1% versus our peers' 1.5% return. While the main indices moved higher, the FTSE AIM All-Share Index (where almost 30% of your fund is invested) actually fell 1.0%. We also suffered from having higher than normal cash levels and being underweight cyclical domestic names such as housebuilders. Looking more broadly, we see a continuing theme running through the market: last year's worst performers, such as structurally challenged retailers, were the stocks bouncing the highest. Our mandate is to look for sustainable structural growth, so you shouldn't expect us to own these types of business.

Our tech names were exceptionally strong over the month, with legacy IT software business **Micro Focus International** announcing solid, surprising (in a good way) results and committing to return capital to shareholders from the sale of its growthiest division. This gave the shares a bump higher; we have been using strength to reduce our holding. We are seeking growing companies, so when one starts returning capital that it has no use for, we think there are better opportunities elsewhere. Luckily, there are other investors who are prepared to pay more for cash now, allowing us to exit at a better price. Engineering and design software business **AVEVA** issued stunning numbers which reflect the benefits of the Schneider software assets it integrated last year. With an exceptional new chief executive, the best products on the market and a partner in Schneider keen to grow the company, AVEVA looks well placed to us. Life insurance administration company **Phoenix** has rallied hard too as market concerns about its solvency were allayed and investors focused on its well-covered and increasingly sustainable dividend.

The one big nasty for us came from **accesso Technologies**, a name we have talked about a lot. This company designs queuing and ticketing software for theme parks, ski resorts and cruise ships. Anywhere you can queue, accesso can help. Less queuing means more time to spend eating, drinking or shopping, a boon for both visitors and the attraction's operator. In February, accesso announced a review of its spending priorities, presumably as it sees so many avenues for growth it has to focus its efforts. Long-standing and well-respected executive chairman Tom Burnet stepped back (while remaining on the board). Some investors took fright over this, along with the risk that the company might need to invest more in its business. As long-term holders who have spent time with the new chief executive, we feel relaxed.

We used the recent market strength, particularly in cyclicals, to trim a few positions that could be vulnerable in a slower growth environment. This included Micro Focus as above, also some of our miners and industrials.

Despite strong performance year to date, UK domestic companies are still more shorted than exporters, understandable given we have no resolution to Brexit as yet. The question is how much further these names can run given softness in the economy. We think there needs to be a pick-up in activity before investors get much more excited about the prospects for UK-facing businesses. If an orderly Brexit is delivered, we expect to see a sharp jump in sterling and higher gilt yields based on better GDP growth. This scenario could be a headwind for the FTSE 100 – where we are very underweight. Our exposure is mainly in the FTSE 250 and upper end of AIM, areas that should benefit from higher domestic growth and a stronger pound putting more purchasing power in people's pockets.

In the meantime, as we become more comfortable that a no-deal Brexit is off the table, we're putting cash to work in selected domestic and overseas-facing businesses. There are myriad opportunities and threats for UK PLC to refocus on once this unedifying period is over.

Alexandra Jackson, CFA
Fund Manager

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Source performance data, Financial Express, bid to bid, net income re-invested.