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Rathbones
Look forward

Rathbone UK Opportunities Fund

Update, January 2019

Markets were up strongly in January, and your fund jumped even higher again. This was a welcome respite after a very challenging end to 2018.

The US Federal Reserve signalled a pause in its tightening cycle, which has put a halt to the dollar creeping higher (for now at least). A record number of Americans are employed, while new jobs and wages have been growing much stronger than expected. Meanwhile the UK's labour market has, actually, been the same as the US. Unfortunately, its press haven't been focusing as much on that … Signs look good for a US-China tariff deal, which would lance a particular worry about worldwide trade that has been dimming investors' and businesspeople's dreams about future economic growth. Alas, this is one area where the UK is not in the same boat as America. No such progress seems to be on the cards with Brexit, although a growing view that MPs will move to block a no-deal exit – even at the last minute if necessary – drove a rally in sterling and UK domestic-facing stocks. And so the FTSE All-Share Index rallied 4.2% in January, the best start to a year since 2013, but slightly underperforming other global markets. This was frustrating given the value on offer in the UK, but not wholly unexpected given the chaos in Westminster.

Your fund rose 6.0% in the month, compared with +5.4% for our peers in the IA UK All Companies sector. Performance was given a helping hand by the strong showing from more domestically focused mid-caps and AIM indices. Having said that, large miners and retailers were the best sectors over the month (cyclical companies), while defensive pharmaceutical and telecoms names, plus banks, were the worst (and your fund owns none of those). Additionally, our 'growth' style was back in favour. We remain underweight domestic names – we believe Brits are behaving as if the economy is in recession, which is a tough headwind for them to counter. Instead, we own more resilient areas such as **Tesco** (groceries aren't typically discretionary), low-cost gyms (**Gym Group**) and student housing developer and landlord **Unite Group**. All of these businesses fulfil our investment process criteria. We have added to UK real estate in a lower-risk way through **Safestore**, a self-storage business with excellent management. We see structural growth within this sub-sector, as self-storage penetration is still very low in the UK compared to elsewhere in the world and very little new storage space is being built. Safestore actively adjusts its prices depending on vacancies to optimise profitability, and has a sensible balance sheet.

We took part in a placing for listed venture capital fund **Draper Esprit**, which raised £100m to fund a stake in two early-stage European investment funds and bolster its capital stockpile ahead of further deals. The trick for Draper will be having enough eyes and ears to ensure access to the best, most exciting early-stage companies out there. It focuses on investing in early funding rounds for swiftly-growing private technology and consumer wellness companies. Recent stakes include prepaid debit card and currency exchange firms Revolut and TransferWise, nutritious snack supplier Graze and artificial intelligence chip developer Graphcore for example.

Indeed, Unite Group was our top contributor this month; it seems more investors are warming to this sub-sector of the property market as other areas, such as shopping centres, look increasingly vulnerable to changes in retailing business models. **ASOS** has bounced hard, up 17% in January after its surprising profit warning in December. We suspect that management were overcautious in cutting their expectations for this year. Tesco issued some very reassuring numbers and emerged, amongst its competition, as the 'winner' of the Christmas trading period.

Gym Group performed poorly after a set of numbers that failed to address new market concerns about competition in the low-cost gym market. Our view is that Gym Group remains fairly unique and it should be able to cut prices as a way to grow its market share. Document storage and shredding business **Restore** continued to struggle through unremarkable numbers as the chief executive hands over the reins for the next phase of growth. We have always liked Restore for its visibility of revenues (boxes of documents tend to stay in the vault for a long time), sticky customer relationships and ability to eke out cost savings over time. But the impact of GDPR is taking its time to work through both the storage and shredding businesses, and along with some self-inflicted wounds and a change of management, we can see why the shares have been de-rated.

We have been using the market's strength this month to trim some large holdings (miners, real estate) which have performed very strongly. Cash stands at 7% – there are a number of interesting companies raising money in the market this quarter and we wish to have firepower to support these, as well as some further new holdings in our core mid-cap growth space. After the rally, markets feel somewhat uncertain again, but supportive noises from the Fed and President Donald Trump as well as any certainty around Brexit will be helpful in the near term. And, while GDP growth around the world is undoubtedly softening and earnings expectations therefore need to be set more realistically (read: lower), this doesn't prevent markets from going higher. Earnings were broadly *higher* over the past few months of lower stock prices, all it would take for a reversal of that dynamic is for one or two looming risks to dissipate.

Alexandra Jackson, CFA
Fund Manager

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