Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone UK Opportunities Fund

Update, June 2019

Over the quarter, your fund returned 5.3% versus 3.6% from our peers in the IA All Companies sector. This leaves us up 13.6% year to date versus 12.9% from peers. Strong results from some of our largest positions drove outperformance in the second quarter against a backdrop of large-caps beating mid-caps and AIM, a dynamic which is typically a headwind for the fund.

Over the month, however, your fund rose just 0.4% versus our peers' 2.4%; being underweight FTSE 100 Index defensive names was a drag.

The first half of 2019 hosted the broadest equity market rally in over a decade, contrary to the way it felt most of the time. Despite worries about trade wars, Brexit and elections, the US Federal Reserve was able to inject further strength in markets by signalling an upcoming interest rate cut. Financials, industrials and energy names were the strongest during the quarter, markedly outperforming telecommunications, utilities and staples names. Investors returned to growth stocks and those that consistently provide strong reliable earnings – qualities that your fund also seeks. Valuations for these types of stocks have moved significantly higher; in this uncertain environment this is absolutely what we would expect to see. Companies demonstrating stability of revenue, returns, cash flow, management and strategy can continue to command premium ratings for extended periods of time. We have been gently taking a few profits from these sorts of companies (health and safety firm **Halma** is a good example); these types of businesses are the cornerstone of the fund, but it is unwise to let positions become concentrated. More examples below.

Intermediate Capital Group (ICG) was our top contributor this month as demand for alternative assets continues to grow. ICG has the track record to attract record inflows. The closed-end nature of the funds not only means liquidity is not a big issue, but that fee pressure is limited compared with the rest of the asset management industry. Several brokers have become increasingly bullish on the stock, and having risen close to 50% this year, we have been locking in a few profits.

AVEVA Group, the engineering design software company, continues to perform very strongly following its merger with the software bits of Schneider. AVEVA has become a global leader in its niche. Its tie-up with Schneider has allowed it to win some very big clients that it would not previously been able to. AVEVA has now entered the FTSE 100 index, so we have been taking a few profits here too (the stock was up almost 70% in the first half).

XPS Pensions Group was our biggest disappointment. This should be a steady, middling growth business in a boring-yet-essential part of the market, using great cash generation to keep adding to its client book. Unfortunately a couple of management missteps earlier in the year seem to have caught up with XPS, resulting in lower growth in its core pensions business. While we are often able to look through such issues, for us this has called into question some of the key attractions of the stock and thus we have exited our position with regret.

Looking ahead to the second half of the year, we are cautiously optimistic, notwithstanding the recent slowdown in global growth and macro data. We believe this weakening should be short-lived, like many others we've experienced in this market cycle, rather than the beginning of a sustained downturn.

We are therefore unsurprised to see the market playing defence: finally coming round to seeing the quality that we had already spotted in many of our holdings. Seeing a strong run for many of our companies, despite continued Brexit opacity, is nice to see. Hopefully Brexit can be satisfactorily resolved soon, leading the market to fully acknowledge the potential of the many small UK companies doing truly fascinating work below the surface of the headline FTSE 100.

Meanwhile, liquidity in our fund remains high and is a constant focus, monitored on a daily basis. More formal stress tests are also in place. We have raised cash levels slightly and waiting for opportune moments to put it to work.

Alexandra Jackson, CFA
Fund Manager

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