

Investing for growth: how to Brexit and Corbyn-proof your portfolio

by Chris Rodgers, Head of UK Equities

It has been a challenging period for UK equity investors since the UK voted to leave the European Union (EU).

Keeping up with developments on the political scene has felt akin to watching a soap opera. There have been many twists and turns along the way – culminating in the key protagonists reaching a deadlock, with little clarity on a resolution any time soon.

With two Brexit extensions granted so far and a deal yet to be reached between the UK and EU, things have moved from bad to worse since Theresa May announced her resignation as leader of the Conservative party. As the Tory leadership race ramps up, political risk has reared its ugly head once again as we prepare for a new Prime Minister.

The path ahead looks uncertain, and a no-deal Brexit is still very much on the table. Meanwhile, May's resignation has raised the prospect of another general election, which could pave the way for a Labour government led by Jeremy Corbyn.

This brings into focus an important question for investors: namely, how to tackle political risk in portfolios. As an investor in UK equities, this has very much been at the forefront of our thinking over the past three years. The Brexit vote back in June 2016 underscored the importance of running a balanced portfolio in terms of style, theme and political risk. It also highlighted the perils of being over-exposed to a single outcome.

So as we enter a fresh period of uncertainty, here are my top tips for tackling political risk:

1. Focus on quality - In the Sanlam Active UK fund, we target companies with strong balance sheets, high returns on invested capital, sustainable and visible barriers to entry, and low levels of gearing. We like businesses with unique growth drivers – regardless of what the political or economic environment throws at them. IntegraFin, the parent company of investment platform Transact, is a prime example. We like that it is gaining market share and enjoys high recurring revenues.

2. Safety first - One way to protect your portfolio against political risk is to avoid companies that are directly exposed to the UK's planned exit from the EU (whichever course it takes), as well as a potential incoming Labour government. We like to think of this as a 'safety first' strategy. This helps to explain why we have significant exposure to overseas earners – and when it comes to our domestic exposure, we are very selective. For example, we don't hold any utilities in the portfolio. As it happens, we don't find these businesses attractive and we are cognisant of Labour's threats to renationalise the UK's energy infrastructure if they get into power. Likewise, we are avoiding British Aerospace, which could massively be at risk if a Labour government decided to cut back on programmes.

3. Selectivity is key - When it comes to domestically-focused stocks, we target those with quality business models, which should prove resilient when faced with tougher conditions. Whitbread is a good example. It has performed well in recent years and disposed of Costa at a phenomenally good price. Today, it represents a pure play on Premier Inn hotels.

We also like Howden Joinery. While this company is focused on the building industry and has a degree of cyclicity, it has a unique business model serving wholesale builders, enjoys high returns on invested capital and grows organically over time.

4. It's all about balance - One of the key lessons we learnt from the Brexit vote is that no-one has a crystal ball, so it is important to run a balanced portfolio. This is why we have exposure to sterling, as well as overseas currencies via companies with international earnings.

A large chunk of the Sanlam Active UK fund is currently invested in companies with

international earnings, which are unlikely to be impacted significantly by the outcome of Brexit.

Intercontinental Hotels, which owns the Holiday Inn brand amongst others, is a prime example. More than 70% of its earnings come from the US and we like that it has an asset-light model: in the majority of cases it doesn't own the hotels, but simply takes a share of revenue. With no pressure to build hotels themselves, Intercontinental Hotels has a high return on capital and reduced risk, which means the business should prove resilient in the face of a slowdown. It is growing organically, is not overexposed to the UK economy and looks attractively valued in comparison to peers.

We also try to make sure we have a balance between growth and value stocks in the fund. For example, we were tempted into Rolls Royce on account of its attractive valuation, strong management team and overlooked recovery potential. The company is coming to the end of a restructure and we should start to see the benefits of that coming through. It also stands to benefit from growing demand for air travel, as one of only two suppliers of engines for wide-body jets.

5. Don't overlook the opportunities - The UK currently faces a number of unknowns - not least a new prime minister who will determine the course of Brexit, and the potential for another general election. However, many investors continue to overlook the wide range of opportunities available in the UK.

Even when you accept the potential risks and prepare for the worst, the UK is home to a host of companies with quality business models, overseas earnings and strong growth characteristics. However, we are finding that they are being tarred with the same brush as companies which are exposed to potential domestic challenges.

We believe there are plenty of stocks which have the potential to withstand Brexit and a new prime minister. What's more, they look attractively valued. Investors must be careful not to rule out the UK.

Past performance is not a guide to future performance

There is no certainty the investment objectives of the portfolios or strategies mentioned in this document will actually be achieved and no warranty or representation is given to this effect.

Issued and approved by Sanlam Investments. Sanlam Investments is the trading name for our two Financial Conduct Authority (FCA) regulated entities: Sanlam Investments UK Limited (FRN 459237), having its registered office at 24 Monument Street, London, EC3R 8AJ and Sanlam Private Investments (UK) Ltd (FRN 122588) having its registered office at 16 South Park, Sevenoaks, Kent, TN13 1AN.