Sanlam Investments

Sanlam Active UK Fund

Q3 2019 | Quarterly newsletter

Market recap

Following a strong rally in global equities in the first half of the year we suggested that a period of sideways trading was probably in prospect. We highlighted uncertainty around the US/China trade dispute and Brexit as the key global and domestic UK issues respectively. Three months on this uncertainty continues and in the meantime equity markets ended September broadly unchanged, having sold off in August and rallied in September.

Along the way, global economic growth has continued to slow, led by a contraction in manufacturing activity and slowing global trade. This is undoubtedly in large part due to the US trade war with China that has seriously disrupted global supply chains and prompted a downturn in corporate investment.

A cut in US interest rates and a return to QE stimulus in Europe are helpful measures that provide some solace to markets but don't by themselves address the root of the problem.

In the UK Brexit risks are as acute as ever with the clock ticking down on 31st October deadline with no deal in prospect at the time of writing.

Equity markets suffered a sharp set-back in August as recession fears escalated and global bond yields plunged, creating a near inversion of the yield curve that in turn provided further fodder for scaremongering bears. This environment was reflected in pronounced outperformance by bond proxy, defensive equities in August, only to be reversed in early September as bond yields backed up and recession fears moderated. Indeed, a rare "value" rally took hold in September and the momentum of high quality stocks collapsed as financial, industrial and consumer cyclical stocks enjoyed a brief moment in the sun.

A terrorist attack on a Saudi oil refinery in mid-September triggered a spike in oil prices, but this too proved to be surprisingly short-lived.

Against such an erratic and jittery backdrop it is not easy to discern any consistent message from sector moves over the quarter, other than to say that investors in general are uncertain and confused. The best performing group in the period was healthcare, while the underperformers were materials, energy and information technology, which suggests on balance a more risk averse sentiment.

Fund review

The Fund underperformed the MSCI UK benchmark over the quarter, with both sector allocation and stock selection impacting negatively. An overweight exposure to technology was the main negative factor as this was by far the worst performing sector of the market (albeit a small proportion).

Performance data

	Inception	QTR	YTD	1yr	3yrs	5yrs	Since Inception
A Accumulation GBP	02/04/07	-1.6	11.0	-0.1	6.6	2.9	4.7
MSCI UK		0.7	13.8	2.8	6.5	6.1	5.0

12 Months to	Sep-19	Sep-18	Sep-17	Sep-16	Sep-15
A Accumulation GBP	-0.1	4.6	16.0	0.7	-5.5
MSCI UK	2.8	5.8	11.0	18.4	-5.9

Past performance is not an indicator of future performance.

Source: Sanlam, Morningstar and Lipper as at 30/09/2019.

Key facts

Fund AuM	£44.3m
Strategy AuM	£44.3m
Number of Holdings	32
Active Share	55.2%
Portfolio Yield*	4.9%

Fund Managers	Chris Rodgers Andrew Evans
Benchmark	MSCI UK
Fund Launch Date	02 April 2007
Domicile	Ireland
Base Currency	Sterling
Fund Type	OEIC, UCITS
IA Sector	UK All Companies
Morningstar Category	UK Flex-Cap
Dealing Deadline	11:00 (GMT)
Settlement Time	T+3
Valuation Point	Midday (GMT)
Distribution	Semi-Annually

*Portfolio yield is calculated by adding the net dividend amounts for all dividend types that have gone 'ex' over the past 12 months based on the dividend frequency.

Performance attribution

The Fund underperformed the MSCI UK index over the quarter, mainly due to the negative impact of our technology holdings, with just two stocks accounting for the majority of the underperformance.

The largest single negative impact came from our holding in First Derivatives which fell sharply in the quarter, initially in response to the placing of just over 5% of the equity from founder and CEO Brian Conlan, and then further following the sad news of his passing away from cancer just four weeks later. The group continues to trade very well and there is no reason to suppose that this loss will be detrimental to the fundamental growth prospects of the company. We therefore see this as a short term set-back for the shares that can be fully recovered in due course.

The other significant negative came from Micro Focus, where the shares fell 32% on a trading update as the group clearly continues to struggle with the integration of the HP Services business acquired in 2017. Annoyingly, this warning came just six weeks after the CEO sold over half his total shareholding, raising over £11.5m. It was accompanied by an announcement of a "strategic review" of the business, which signifies the depth of the problems. For this reason we decided to exit our positon entirely.

A handful of other holdings had minor negative impacts, including Sage (marginally disappointing Q3 results), Prudential (Hong Kong exposure), Whitbread (weakening room rates and occupancy at Premier Inn) and Rolls Royce (continuing rectification work on the Trent 1000 engine).

Partially offsetting these was a significant rally in Flutter Entertainment (the old Paddy Power Betfair), following positive interim results announced in early August. Good gains were also achieved in travel business Tui, where trading has stabilized and the group is likely to be a major beneficiary of the bankruptcy of key competitor Thomas Cook. Surprisingly perhaps given ongoing Brexit uncertainty, several of our domestic holdings performed well, especially Howden Joinery and Great Portland Estates. Finally, stock selection was positive in the materials sector courtesy of our holding in CRH and the absence of a positions in Glencore and BHP.

Outlook

The outlook for the UK and global economy has undoubtedly worsened over the last three months. Uncertainty around Brexit and global trade friction remain the main factors contributing to a corporate capex slowdown but, more recently, weakness in manufacturing output is starting to feed through to the services sector.

Equity markets have been unnerved by this slowdown, but not unduly so. Hitherto bearish sentiment has been contained as investors have welcomed the consequent loosening of monetary policy and the anticipation of more to come.

Furthermore, it is by no means clear that slower growth will necessarily result in a full recessionary contraction of activity. In contrast to previous downturns, there are no real imbalances creating instability or needing to be exorcised. Inflation is restrained (perhaps worryingly so!), bank balance sheets are strong and there is no tightening of credit conditions, commodities are not in short supply and consumers have been restrained despite full employment and rising real wages.

Indeed, it is not too much of an exaggeration to say that many of the economic problems seem to be self-inflicted, being a function of political uncertainty and ineptitude. Confidence could therefore return quickly in the event of a Brexit deal and a truce in the global trade war.

In summary, we believe that it would be wrong to be too bearish at a time when sentiment is already cautious given the relatively modest valuations of global equities (UK especially) and the scope for positive surprise outcomes as current issues are resolved. In the meantime, we manage downside risk by focussing our investments on high quality companies, with low financial gearing and secular growth potential.

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The Fund invests geographically in a narrow range, there is an increased risk of volatility which may result in frequent rises and falls in the Fund's share price.

The value of this portfolio is subject to fluctuation and past performance is not necessarily a guide to future performance. The performance is calculated for the portfolio and the actual individual investor performance will differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. All terms exclude costs. Fluctuations or movements in exchange rates may cause the value of underlying investments to go up or down. Do remember that the value of participatory interests or the investment and the income generated from them may go down as well as up and is not guaranteed, therefore, you may not get back the amount originally invested and potentially risk total loss of capital. Therefore, the Manager does not provide any guarantee either with respect to the capital or the return of a portfolio. The Manager has the right to close any Portfolios to new investors to manage them more efficiently in accordance with their mandates. Collective Investment Schemes are traded at ruling prices and can engage in borrowing and scrip lending. Collective Investment Schemes (CIS) are generally medium to long term investments. A schedule of fees and charges and maximum commissions is available on request free of charge from the Manager, the Investment Manager or at www.sanlam.ie.

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