Sanlam Investments

Sanlam Active UK Fund

Q3 2020 | Quarterly newsletter

Market recap

The UK market has been in a prolonged consolidation phase during the quarter, trading gently down throughout the period, in contrast to most other major equity markets, which only started to see profit -taking from the end of August. The MSCI UK Index ended the quarter down 4.6%, while the fund was down 1.1% over the period.

Economic recovery from the depths of lockdown has been predictably strong as previously shut-in businesses have re-opened. However, this had already been discounted by the stock-market rally from the lows in March, whilst the more recent market correction became entrenched as the viral infection rate jumped back up, particularly in the north. This prompted a series of renewed local lockdown and restrictions on the hospitality trade, while the vacillating government policy response has elevated uncertainty and hit confidence across the entire nation. The added delay to achieving a successful trade agreement ahead of Brexit looming at year-end has not helped.

The UK market has also suffered relatively as a result of its composition, with a heavy exposure to the poorly performing energy and financials sectors, and relative dearth of fast-growing technology stocks. While international investors might have worries about frothy valuations on the US markets there is certainly no accusation of irrational exuberance being levelled at the UK!

Globally, growth continues to be led by the recovery in China and the US (notwithstanding the fact that much of the USA is still in the grip of the pandemic). Sector-wise, manufacturing has generally recovered more strongly than services. Consumer discretionary and technology stocks have led the market, while the worst performance by some margin has come from the energy sector. Both BP and Royal Dutch Shell have struggled in the face of a weak oil price and the need to invest heavily in renewable energy technologies in order to transition their businesses towards a zero carbon future.

Fund review

The fund out-performed the MSCI UK benchmark over the quarter, driven both by positive stock selection, as well as sector positioning. The key components of the sector positioning were our zero exposure to the poorly performing energy sector and a commensurately overweight stance in consumer discretionary sectors. The positive stock selection contributions came from a combination of shares starting to recover from the pandemic-induced downturn, as well as a handful of high growth stocks that seem to have sailed through the recession. The main recovery situations so far have been Intercontinental Hotels, Rightmove and Howden Joinery, while the key growth stocks contributing positively were First derivatives, Flutter Entertainment, Integrafin and XP Power. Finally, our relative performance against the index also received a boost from not holding the oil majors, BP and Royal Dutch Shell, as well as HSBC, which has suffered badly from being caught in the middle of the Hong Kong political clamp-down imposed by China. The main stocks detracting from performance were generally those with most direct exposure to the UK domestic economy, namely Taylor Wimpey and our bank holdings, Barclays and Lloyds. In addition,Rolls Royce also suffered badly from sharply lower revenues at its civil aviation division as a result of restrictions on air travel caused by the pandemic.

Performance data

	Inception	QTR	YTD	1yr	3yrs	5yrs	Since Inception
A Accumulation GBP	02/04/07	-1.1	-18.2	-12.1	-2.8	1.4	3.3
MSCI UK		-4.6	-21.5	-19.8	-4.4	2.8	2.9

Performance beyond one year is annualised

12 Months to	Sep-20	Sep-19	Sep-18	Sep-17	Sep-16
A Accumulation GBP	-12.1	-0.1	4.6	16.0	0.7
MSCI UK	-19.8	2.8	5.8	11.0	18.4

Key facts

Fund AuM	£82.3m
Strategy AuM	£82.3m
Number of Holdings	27
Active Share	66.6%
Portfolio Yield*	2.2%
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

Past performance is not an indicator of future performance.

Source: Sanlam, Morningstar and Lipper as at 30/09/2020.

*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

We were able to purchase two new exciting holdings in the quarter, which should contribute meaningfully to fund performance in the future. They are both medical devices and supplies companies, both US-listed. The fund is permitted to invest up to twenty percent of its capital into stocks not listed in the UK. Both these new holdings pass our quality filter with high returns on capital and growth potential, and both were bought at discounts to our estimates of their intrinsic value. They now comprise c. 6% of the fund between them.

Becton Dickinson is a global medical devices and supplies business with a long and prosperous history. They are global number 1 or 2 in each of their business unit categories, which includes mostly single-use consumable products in Medical (medication management, syringes/needles and infection prevention), Life Sciences (diagnostics tools and products for medical labs), and Interventional (surgery products, catheters, surgical mesh etc for vascular disease, cancers and renal disease). They have good core growth in the mid single digits driven by ageing populations and increasing access to healthcare in emerging markets. The company has experienced some temporary issues in a few product lines, weighing on the share price and allowing us to purchase our position, but we believe the core of the business is growing more than the market anticipates. It's a very high quality business with c. 40% Return on Tangible Capital, and the shares are undervalued.

Conmed is also a well-established company, but is much smaller, with more growth potential. It has the same overall growth drivers as Becton, but is a simpler business. Conmed has two segments, Advanced Surgical Products and Sports Medicine. The company has been reinvigorated by a very high-quality management team that came on board in 2015, and revenues are growing in the mid-upper single digits. The shares sold off heavily this year as COVID resulted in many hospitals stopping their normal surgical procedures. Surgeries will recover in time, but even more excitingly, Conmed has exposure to robotic surgery through their Air-Seal platform. Conmed could become a very much larger company in time, and we used the sell off this year to establish our position.

Outlook

The UK stock market remains depressed, with the MSCI UK Index down 21.5% year to date. This is partly a reflection of the composition of the UK market, which has heavy weightings to economically sensitive sectors like energy, financials, materials, and very little exposure to technology, unlike the US stock market. The economic recovery from the April low has started, but the pace and shape of that recovery remains uncertain, especially in light of rising cases of COVID in many parts of the UK in the past few weeks. The most depressed sectors of the economy, for example hospitality/tourism and aerospace, remain weak, and that is reflected in share prices of the relevant companies in those sectors. Additionally, the Brexit negotiations and the US Presidential election are likely to weigh on sentiment for the next few months. The timeline of the development of an effective vaccine is uncertain, but it remains a potential gamechanger in terms of allowing the world economy to open again.

We are encouraged by the fund's outperformance of the benchmark for the year to date, which has been a sorely trying one for investors. However, we remain well aware that the fund, while outperforming, remains down for the year by 18.2%. This is a matter of some frustration because we do not believe the companies we own (looking at the fund as a unit) are worth 18% less than they were at the beginning of the year.

We are high conviction investors with a quality overlay. This means that though we have a fairly concentrated fund in terms of numbers of holdings (27), every stock we hold is first and foremost assessed by whether it meets quality criteria. Owning better businesses tends to lead to better business outcomes over time, and as long as we do not overpay for them, better outcomes for their stock prices. Share prices follow fundamentals, and we think the fundamentals of the portfolio of stocks we hold are very attractive. We also remain well diversified, with holdings in nine of the eleven GICS sectors.

The extreme fluctuations this year may have been painful, but they have allowed us to purchase four very good new companies for the fund at valuations that we think will deliver very good long term returns. These new holdings year to date are Diageo, Rightmove, Becton Dickinson and Conmed.

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Important Information