Rathbone UK Opportunities Fund Alexandra Jackson - Fund Manager

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0:28
Year to date the fund is up 7.4%.

0:31
That compares to the benchmark up 9.5%.

0:33
That leaves us in 3rd quartile against our peers.

0:36
Large caps have outperformed mid caps despite the first interest rate cut from the Bank of England and strong sterling.

0:42
But small caps have outperformed them all and are now the best performing asset class over the last 12 months, a fact that isn't getting much attention.

0:50
So our asset allocation in the fund of being triple overweight mid caps and hugely underweight large caps hasn't added much alpha so far this year.

0:57
We aren't in some of the top performing heavyweights like Astra and Unilever as you'd expect.

1:03
Our sweet spot that's mid cap quality growth, it's rather stuck still on the starting blocks.

1:08
Stock wise though, we draw out a couple of themes, both of which have been strong drivers of performance, M&A and buybacks.

1:15
Long standing holding in the video game space, Keyword Studios was bid for in May by private equity and after a couple of revised offers, we've taken the decision to sell our entire holding and recycle that cash into new and existing positions.

1:28
Fund administration business JTC has had a phenomenal year as well.

1:32

Operationally, they're firing on all cylinders after a couple of nice acquisitions and a new three-year plan to double revenue and EBITDA.

1:39
Publishing business, Bloomsbury, a newer holding for us, it's up 40% this year thanks to very strong sales particularly from it's young adult romance fantasy genre and again a really good looking acquisition in the academic publishing space.

1:52
Broadly, our holdings in the financial sectors have also been strong intermediate capital.

1:56
They continue their superb growth in the alternative asset space with 50% plus margins and limited regulatory overhang.

2:04
It really stands out to us amongst asset managers.

2:07
Specialty insurer Beasley up 50% thanks to an exceptionally strong underwriting performance in its cyber book.

2:13
They're really proving themselves as best in class pioneers here.

2:17
AJ Bell benefiting from high activity levels across the savings and investment platforms and some read across from the Hargreaves Lansdowne bid.

2:24
But on the negative side, our biggest drag was Bytes Technology.

2:27
The shares took a tumble early in the year when it was revealed that the CEO had been improperly dealing in his own stock.

2:33
We've been reducing our holding before that as the stock had had a great run and we prefer balance in the fund, but certainly we weren't expecting that news.

2:41
We've reduced our holding again since to reflect some concern that the AI cycle might be a little bit overhyped.

2:47
For now, Bites is a great business, but when expectations get too high, even great companies will struggle to perform.

2:59
I think it's really simple for the UK right now.

3:01
More growth, less inflation, stable politics.

3:04
The UK economy looks healthier than it has in a number of years and compares well to other global markets.

3:10
GDP is recovering, inflation is back at Target.

3:13
We are no longer the economic outlier, yet valuations still suggest that we are.

3:17
Some market participants have started to notice this better economic momentum though.

3:22
While fund flows continue to be negative at the headline level, beneath this there is a marked positive change in flows into smaller mid caps corporates too.

3:30
They're taking action against the depressed share prices.

3:33
Historically, one in 10 UK corporates is undertaking a buyback.

3:36
Currently it's one in 3-4 out of the top ten in this fund are buying their own shares.

3:41
Private equity is noticed too.

3:42
M&A is surging.

3:44
Aside from keywords, we've also had our long standing holding right move bid for in September.

3:49
Sterling has spotted the improved macro momentum too.

3:51
It's the best performing G10 currency year to date.

3:54
The Bank of England has noticed and they've been able to start cutting rates.

3:58
Meanwhile, the Prime Minister and the Chancellor are studiously ignoring all of this good data in favour, we think, of softening up the electorate ahead of an important budget.

4:07
We think they should take a look at the misery index.

4:09
That's unemployment plus inflation.

4:11
It's historically low.

4:13
In fact it's never been this low when a new party has come into power.

4:16
Not all plain sailing, of course.

4:18
The Budget could contain some nasty surprises.

4:20
But there is a tangible change in the economic performance of the UK.

4:24
There is a tangible change in the pecking order versus the US and Eurozone, but there is no change in relative valuations.

4:30
The UK is trading on just over half the PE multiple of the US.

4:35
Our preferred hunting ground.

4:36
The FTSE 250 on 12.4 times, the FTSE 100 below 12 times.

4:41
Contrast this with the S&P on 22 times for slowing lead indicators.

4:51
There's certainly no flood of listings.

4:53
Perhaps a trickle.

4:54
The float in June of Raspberry Pi was a really important milestone for London though.

4:59
This is the world's best known maker of single board computers.

5:02
Here's one I programmed earlier.

5:03
This costs around $5.

5:05
Raspberry Pi is a hugely strong brand.

5:07
Your children probably know it from the classroom.

5:09
Since 2000, these low cost, high performance boards have been used to encourage kids to play with computers, and not just on them.

5:16
But roll forward 24 years and those school children are now pretty senior engineers at some of the world's largest industrial companies.

5:23
And they've brought Raspberry Pi computers with them and now deployed in 10s of thousands of applications across industries, for example, in a professional grade seismograph that is scalable and affordable.

5:33
Cutting edge car manufacturers use these to detect flaws.

5:36
That's important when you have a highly robotic process making a car every 72 seconds.

5:42
The shares rose over 50% after floating in June.

5:45
We need to see the first set of results from this company.

5:47
But we were really pleased to get an allocation where half of the fund managers who applied got nothing.

5:52
It shows that high quality, well placed business can have a successful float on the London market and we think it will open the door to others.

6:05
Having no benchmark constraints and being able to apply our global lens to the whole of the UK market to find quality growth companies means the fund is predominantly invested in the high return on equity sectors, forsaking the lower commodity driven areas.

6:18
So we have no banks, no oils, no miners, no tobacco, no utilities and no telcos.

6:24
The fund looks more like a global index than AUK benchmark.

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Our big overweights are in high margin niche industrial and technology businesses.

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Also lots of real estate, again, niches like student accommodation, warehousing with big waitings to companies set to benefit from lower rates.

6:40
And in terms of market cap, again, the fund looks very different to the benchmark, which triple overweight the FTSE 250 with 31% in the FTSE 100 compared to 84% in the benchmark.

6:51
So big differences across asset allocation and sectors.

6:54
So performance will also differ markedly from the benchmark.

6:58
We've put some metrics here to help guide you as to which market environments the fund is likely to perform in and when it will struggle.

7:04
As you'd expect from a quality growth process, the portfolio has a higher return on equity, higher return on invested capital than the benchmark, much faster sales growth.

7:12
And again, as you'd expect, it trades on a premium multiple.

7:15
But in context of those quality and growth metrics, it's still good value while else being equal.

7:27
We expect a gradual easing of interest rates alongside QT as inflation is very close to its target.

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And typically, when interest rates fall, it's the midcap area of the market that outperforms large gaps due to higher economic and debt sensitivity.

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In these names.

7:41
As borrowing costs surged from 2021, large caps outperformed.

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So it stands to reason that as rates roll over, SMID caps could be in the vanguard.

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A similar correlation exists with sterling.

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Strong sterling generally leads to midcap outperformance thanks to the domestic tilt in the index.

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These two factors together suggest midcaps are prime to perform and we think that's contributing to the better flows in the space.

8:10
Positive earnings momentum is an essential driver of equity market performance, so we try and weight the portfolio towards this factor and we expect a nice RE rating to occur in UK assets in recognition of that improvement in the economy and political landscape.

8:25
That double whammy of higher earnings plus a RE rating can be really powerful.

8:29

We think the consumer space has the right ingredients for this set up and we've been adding to our exposure.

8:34
The UK savings rate is currently at 11%.

8:37
That's materially higher than in the US and much higher than our usual level of 8%.

8:42
Combined with steadily improving consumer confidence post budget, we expect some of these savings to be unleashed.

8:48
Howden Joinery, the kitchen manufacturer, is in prime position to benefit when consumers release the brakes a little.

8:54
Competitors have started tentatively mentioning this already, JD Sports, Greg's, WH Smith, they would all benefit too.

9:02
And we've taken a new position in online personalised card company Moon Pig.

9:06
This is a really nice platform business with the levers to pull around sending high margin gifts alongside cards as and when the consumer is ready to loosen the purse strings a little.

9:16
Our other big sector overweight in real estate.

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That's the area of the market most correlated to falling interest rates.

9:22
But thinking about the market more broadly, valuation suggests that the UK is still suffering from no growth, high inflation, volatile politics.

9:31
In fact, the reverse is true and once the budget allows for some certainty over the tax treatment of UK assets, we are positioning for a meaningful move higher, led by quality mid caps.