Liontrust UK Growth Fund

September 2022 review

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The Liontrust UK Growth Fund returned -3.8%* in September. The FTSE All-Share Index comparator benchmark returned -5.9% and the average return in the IA UK All Companies sector, also a comparator benchmark, was -7.1%.

A higher-than-expected US inflation reading (8.3% year-on-year for August) removed any small possibility that inflation would drop out of investors' key concerns during September. The US Federal Reserve reacted by raising rates a further 75 basis points – its third consecutive hike of this size – and commenting that further economic pain was likely as more tightening is implemented

Equity markets softened and government bond yields rose, trends which were accentuated in the UK towards the end of the month by an adverse market reaction to UK Chancellor Kwasi Kwarteng's 'mini-budget'. Having already committed support worth an estimated £150bn to cap household energy bills, the Chancellor went on to announce a package of fiscal stimulus which included around £45bn of tax cuts. Additional borrowing of £72bn will be needed this year to support the plans; markets signalled strongly that they viewed the measures as damaging to the UK's credit quality. In trade-weighted terms, the pound lost almost 5% to its low on 26th September. UK Government bonds sold off extremely sharply, with, for example, the 5 year bond hitting a high of 4.7% on 27th, up nearly 200 percentage points on the month and up by around 110 points since the budget announcement a couple of days earlier. At this point, the Bank of England moved to stabilise markets – temporarily reinstating its bond-buying quantitative easing efforts – over fears of potential systemic solvency issues for some pension funds.

On the UK equity market, these events only served to deepen the year's existing trend of weakness concentrated in mid and small caps. While the large-cap FTSE 100 monthly return of -5.2% was bad enough, the mid-cap FTSE 250 returned -9.7% and the FTSE Small Cap registered -8.5%.

Earlier in the year, share weakness in these areas seemed to stem predominantly from ratings contracting – i.e. the 'p' in p/e levels falling – as investors priced in higher interest rates (and discount rates) on future expected growth. More recently, as recessionary forces have built, earnings estimates have come under pressure, prompting further share price weakness.

It is understandable that the market might be concerned that mid and small-caps in aggregate would be disproportionately affected by the problems faced by the UK's domestic economy. While we by no means claim that any of our companies will be immune from a contraction in the UK economy, we have so far been reassured by the trading resilience shown by many of them. Over time, we would expect their high-quality characteristics to allow them to outperform the average company, especially against a tough economic backdrop.

Inevitably, markets use a very broad brush when reacting to economic developments and do not differentiate between different companies until later in the cycle when the successful ones are able to show, by their delivered results, their superiority. We believe that our funds are invested in dependable, consistent businesses in possession of barriers to competition which gives them pricing power. This pricing power is likely to prove critical in dealing with cost pressures that look set to persist for some time.

In the meantime, we have been trying to view the UK market sell-off as a period of disruption which should present investment opportunities, particularly lower down the size scale. We have been looking for opportunities to initiate or top-up positions in high-quality, strong businesses with Economic Advantage characteristics at materially cheaper levels than we were able to at the start of the year.

Within a decidedly risk-off environment, the portfolio's heaviest faller in September was **Synthomer** (-46%) after it issued a profit warning. Full-year EBITDA now forecast to be 10% to 15% below the levels it communicated at the time of its interim results release only a month ago. It commented that the macroeconomic conditions have deteriorated more than expected, while demand in its nitrile butadiene rubber division is set to be impacted by post-pandemic medical glove destocking for longer than previously anticipated.

Moonpig (-19%) shares fell heavily despite an AGM update describing trading since 30 April as in line with its expectations and on track to meet full-year financial guidance. Investors looking for signs of exposure to weakening consumer spending may have focused on its decision to prioritise greeting card sales over gifts due to their greater historic resilience to economic downturns. Moonpig also reassured that margin trend remain resilient, with no significant pressure from input cost inflation.

Likewise, a share price fall for **WH Smith** (-16%) looked to be driven by top-down considerations after a full-year trading update confirmed that results are still on track to meet the guidance which it upgraded in June.

The portfolio's handful of risers was led by interdealer broker **TP ICAP** (+27%), which often benefits from market volatility. Within last month's interims it commented that its Rates division had been very profitable and would benefit further were activity to pick up at the long end of the bond yield curve.

There was also a positive monthly return for **Haleon** (+7.9%) after its maiden set of results as an independent listed company following its spin-off from GlaxoSmithKline, a long-standing fund holding. We received shares in Haleon as part of the spin-off and have since topped it up to target position size. As with GlaxoSmithKline, we believe it possesses intangible barriers to competition in the form of intellectual property and distribution network strength.

Positive contributors included:
TP ICAP (+27%), Hargreaves Lansdown (-9.6%), Haleon (+7.9%), BAE Systems (+1.8%) and Unilever (+1.1%)

Negative contributors included:
Synthomer (-46%), Rightmove (-20%), Moonpig (-19%), TI Fluid Systems (-18%) and WH Smith (-16%).

Discrete years' performance (%), to previous quarter-end:**
Past performance does not predict future returns

	Sep-22	Sep-21	Sep-20	Sep-19	Sep-18
Liontrust UK Growth I Inc	-5.5%	26.1%	-11.0%	3.0%	9.4%
FTSE All Share	-4.0%	27.9%	-16.6%	2.7%	5.9%
IA UK All Companies	-15.3%	32.4%	-12.8%	0.0%	5.5%
Quartile	1	3	2	2	1

*Source: Financial Express, as at 30.09.22, total return (net of fees and income reinvested), bid-to-bid, institutional class.
**Source: Financial Express, as at 30.09.22, total return (net of fees and income reinvested), bid-to-bid, primary class.

For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/glossary

Key Risks:

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

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