Ninety One

Investing for a world of change

Exposure to unloved cyclicals could mitigate a challenging outlook

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How has the UK market performed in 2022?

It has been a very challenging year for UK companies. Markets have had to contend with spiralling energy costs, high inflation, rising interest rates, a weak currency and a very unstable political situation. Having said that, the overall UK equity market has held up relatively well, but with incredibly divergent performance. It has been the year of the "sin stock", with energy leading the market and mining and tobacco amongst the few sectors which have delivered positive returns. Meanwhile high growth and cyclical sectors such as technology and retail have fallen significantly.

How have you managed to mitigate some of these headwinds?

The majority of our portfolio is in high quality, international companies which are able to mitigate rising costs through higher prices. Our holdings in energy have also performed well. However, we do have some exposure to high-growth midcap companies which have derated, as have some of our domestic cyclical holdings.

The content of this communication is intended for readers with existing knowledge of financial markets.

How concerned are you about the UK consumer's ability to spend in 2023?

We are very concerned about the pressures facing UK consumers next year. They are being hit by rising prices, rising taxes, rising interest rates and government spending cuts right at the point where we are tipping into a recession. Consumer spending has so far been sustained by high employment, but this looks likely to come under pressure. Higher income households have accumulated savings during the pandemic, but that only provides a small buffer and overall, we think consumer spending is likely to fall in 2023.

Where do you see the risks and opportunities in 2023?

Overall we are quite defensively positioned; we favour high quality businesses which can grow through any environment. For example, those selling repeat purchase, everyday items such as consumer health products should continue to perform well. However, we are beginning to find opportunities to buy stocks in cyclical industries, which are out of favour and already priced for a recession.

For instance, savings platforms provide a much-needed solution to the UK's long-term savings gap, and are priced for lower inflows next year, assuming that people are unable to save as much as they used to. However, the long term demand for savings platforms' services will only grow, and there are many fantastic businesses in this space.

Another sector we are interested in is airlines. We think that people will try and prioritise some level of travel as we emerge from the pandemic, and there are plenty of low-cost operators in the UK that passengers can trade down to. Some of the better-positioned retailers are also beginning to look attractive from a valuation perspective. It is important to be ahead of the curve with these decisions because cyclical sectors typically start to perform before their earnings trough.

General risks. All investments carry the risk of capital loss. The value of investments, and any income generated from them, can fall as well as rise and will be affected by changes in interest rates, currency fluctuations, general market conditions and other political, social and economic developments, as well as by specific matters relating to the assets in which the investment strategy invests. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations. Past performance is not a reliable indicator of future results. Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments.

Specific risks. Equity investment: The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. insolvency), the owners of their equity rank last in terms of any financial payment from that company. Concentrated portfolio: The portfolio invests in a relatively small number of individual holdings. This may mean wider fluctuations in value than more broadly invested portfolios.

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