Ninety One

UK Special Situations

Market context

UK equities declined slightly in December and over Q4, although they outperformed their European peers. The biggest news for the market was the first Labour budget in 14 years. Chancellor Reeves' announcement of significant borrowing led traders to price in a slower rate pace of interest rate cuts over the coming year, weighing on the equity market. Economic data added to the cautious mood. The Office for National Statistics revised Q3 GDP growth to 0%, down from its initial estimate of 0.1%. The Bank of England cut rates to 4.75% in November but held steady in December, citing heightened economic uncertainty. However, the governor signalled a likely downward path for rates in 2025. By sector, financials and technology were among the best-performing parts of the FTSE All-Share Index; real estate and mining stocks significantly underperformed.

Performance

The Strategy delivered a positive return and outperformed the FTSE All-Share Index[1] (in GBP, gross and net of fees). At the stock level, the main contributors to relative returns were diverse and included the following. Shares in insurer Direct Line gained strongly following a £3.7 billion takeover bid from Aviva, which was agreed by the boards in December. Oxford-based automotive parts supplier TI Fluid Systems also received a bid, valued at £1 billion, from Canadian company ABC Technologies. Housebuilder Cairn Homes continued to perform well in Q4 after reporting record first-half results in September. Even after a strong share-price performance last year, the stock still only trades on modest multiples of earnings and cashflows. British bank NatWest delivered good results during the quarter, with net interest margins and non-interest income both ahead of expectations; and with capital at the top of management's targeted range, this increases the possibility of additional cash returns to shareholders. Fashion company Burberry (a Q3 addition to the portfolio) also outperformed, partly on bid speculation. For the past two years, Burberry's shares have been hit by worries about a slowdown in luxury consumption, especially in China. However, we see a brand with enduring value and believe that it will not take a dramatic reinvention, only a return to a proven business model, to realise potentially significant value for investors.

The main detractors from relative returns included the following. Housebuilder Vistry issued a profit warning in October after announcing that costs had been understated on a number of projects, subsequently downgrading profit guidance. Engineering and energy services company John Wood also detracted, after it commissioned an independent review of some of its contracts, as well as disclosing some weakness in its projects segment. Shares in specialist semiconductor firm Qorvo underperformed after the company posted disappointing results. Germany-based auto supplier Schaeffler was impacted partly by concern over how US tariffs may hinder Europe's already out-of-favour auto sector. Finally, the share-price performance of DIY retailer Wickes reflected a slowdown in spending on higher-value home improvement and some concerns over higher costs, including wages.

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[1] Where performance is gross of fees, returns will be reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.

Not all securities held have been discussed. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Past performance does not predict future returns; losses may be made.

Portfolio activity

Significant buys

- Pennon is one the three listed UK regulated water businesses, a sector which is currently going through its five-year regulatory review. Uncertainty over this review, as well as over the company's leverage outlook, allowed us to invest in the company at close to its regulated asset base, which is typically an attractive entry point for stocks in the sector.
- Fever-Tree Drinks makes premium tonics and mixers, traditionally skewed towards the UK, but with the US now a larger, and growing part of the pie. As we pass through a temporary cost spike and margins and earnings normalise, the internal rate of return on offer at our entry point should comfortably be in the double-digits, even assuming a de-rating of the firm's shares.
- We think shares in supermarket Tesco are attractively priced for a low-volatility, high-predictability business. At this price point, investors are effectively getting the potential for positive outcomes for free.

Significant sells

- DirectLine and TI Fluid Systems were sold after the companies received bids.
- Shares in energy company BP appear to have reached fair value.

Outlook

UK stocks remain very cheap relative to global peers, following another year in which global equity benchmarks have been dominated by the US, and by a handful of stocks and sectors. From a strategy perspective, we are very encouraged by the outperformance of our UK value portfolio over 2024 and the healthy absolute return, with contributions from a diverse group of businesses. Whether or not 'value' as a style is having a moment, we remain focused on finding typically idiosyncratic opportunities among good businesses experiencing (hopefully temporary) hard times. Even after 12 months of strong returns, we continue to see substantial value remaining in the portfolio, and an abundance of interesting value opportunities outside it.

From a sector perspective, we commented in the previous quarterly update that autoparts stocks, which we have a significant allocation to in our strategies, are some of the cheapest in the world, and this remains the case. That outlier undervaluation was concurrent with outlier underperformance last year, but the auto sector remains extremely cheap, highly out-of-favour and we believe there is significant value on offer within it. Plenty of other sectors that we have exposure to are also at the cheaper end of the global equity universe, such as financials, insurance and consumer discretionary.

Given the low valuations in the UK market generally, the significant value we still see in our UK portfolio, and the broad and deep pool of idiosyncratic value stories our research continues to uncover, the current state of play should provide a good starting point for delivering returns to our investors in the years ahead.

Our overweight positions are as follows:

- Auto suppliers exposed to a transition to electric vehicles (EVs) and hybrids.
- Travel-exposed sectors and stocks, relating to tourism, aerospace industrials and air travel generally.
- Builder's merchants.
- Housebuilders.
- Insurers.

Specific risks.

Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. Derivatives: The use of derivatives is not intended to increase the overall level of risk. However, the use of derivatives may still lead to large changes in value and includes the potential for large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss. 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.

Important information