Ninety One

UK Sustainable Equity

Market context

Although the UK stock market lagged some other major developed equity markets in Q3, national equity benchmarks advanced amid broadly positive UK newsflow. The Bank of England (BoE) cut interest rates for the first time in four years, although Governor Andrew Bailey cautioned against a premature declaration of victory against inflation. Large-cap stocks generally lagged smaller companies, with the FTSE All-Share Index posting a stronger advance than the FTSE 100. However, consumer confidence fell in September in advance of October's budget, with the new government expected to lay out stringent measures to repair the public finances. At the sector level, consumer staples and utilities were the best parts of the UK equity market, with energy the notable loser on global growth concerns, which resulted in a 17% quarterly decline in the price of a barrel of Brent crude oil.

Performance

The Strategy delivered a positive return and outperformed the FTSE All-Share Index (in GBP, gross and net of fees)[1]. At the sector level, stock selection in healthcare and financials made a notable contribution to relative returns, as did an underweight in energy. As a reminder, the UK Sustainable Equity strategy does not invest in the heavy extractive industries. Stock selection in industrials detracted.

At the stock level, the primary contributors to relative returns included Oxford Nanopore Technologies, which develops technologies used in DNA sequencing and drug development. It outperformed on an encouraging update that highlighted solid growth and improving cashflow metrics; the company also received an investment from Novo Holdings, which provides more financial support and has strengthened confidence in the business. Other contributors included WAG Payment Solutions, which offers a payment and mobility platform for commercial road transport; it outperformed on results that highlighted strong growth. National Grid was another outperformer, rising along with the utilities sector on expectations of interest-rate cuts; the conclusion of a rights issue and clear signs that the fundamentals of the business remain intact also supported the shares. Genus, an elite genetics company that helps improve the efficiency, environmental impact and quality of livestock herds, also contributed on good results, as well as more upbeat sentiment towards China, a major protein market. Finally for the contributors, not holding oil & gas majors BP and Shell benefited relative returns, given the weakness of the energy sector as oil prices fell.

The detractors from relative returns included pest control company Rentokil, which warned on growth in North America and profits, with the business facing ongoing challenges in integrating US acquisition Terminix. PureTech Health, a clinical-stage biotherapeutics company, was another detractor. Current market conditions present a challenge for PureTech Health, but the business continues to do the right things operationally. It has returned over £100m of cash to shareholders and several of its studies are nearing conclusions, which should lead to further commercial progress. Several industrial sector companies also detracted, on broad concerns about end-market demand due to inventory reductions and an uncertain outlook. They included Victrex, which creates high-performance polymer solutions with an industry focus on aerospace, energy and medical markets; Morgan Advanced Materials, which creates materials that help customers reduce energy consumption, emissions and operating costs, detracted; and Oxford Instruments, which

[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.

develops advanced instrumentation equipment for industry and scientific communities.

Portfolio activity

Buys

We added Spectris, a provider of test and measurement systems that help scientists and engineers monitor the environment, accelerate climate mitigation and adaptation, and build resilience. After five years of significant streamlining, the company is now focused on its strong competitive positions, which should lead to a stronger growth and returns profile in the future.

Top-ups included additional investments in Rentokil and Genus to take advantage of valuation opportunities following share-price weakness.

Sells

There were no full exits. We trimmed Ricardo and AJ Bell after strong performances.

Outlook

Even after a decent performance by UK equities in Q3, the UK market continues to trade at a material discount vs. history and global markets. This is reflected in the UK Sustainable Equity portfolio, where the current price-to-earnings ratio is lower than the historical average.

Since 2016, the UK market has had to navigate numerous headwinds: Brexit, COVID, the UK gilts crisis, high inflation and a succession of prime ministers. These events have created uncertainty that has weighed heavily on capital markets. Governing is never easy, as the early days of the new administration show, but we can hope that we have moved into a period of relative political stability. Combined with UK stocks offering good value and rebounding profits, this paints a favourable outlook for the UK market.

At the individual security level, we are excited by the fundamental progress we are seeing. We noted at the end of Q2 that recent data releases have shown operational progress in many of our holdings. Q3 saw more of the same, with encouraging updates from other companies in the portfolio, including Oxford Nanopore Technologies and WAG Payment Solutions, among others. We expect this to translate into further earnings growth later this year. And as earnings grow, we anticipate valuations will follow and ultimately align with the underlying fundamentals.

At this point in time, future earnings growth has still not been priced into the market. The current earnings-growth ‘down-cycle’ has been an extended one and, although matters have stabilised, there remains inventory uncertainty and caution over end-market demand, which is leading to some reticence on investment decisions and ordering patterns. However, we expect this to resolve in time, and continue to believe that the combination of attractive valuations and strong operational performance creates a significant opportunity for UK equity investors.

Specific risks.

Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. Default: There is a risk that the issuers of fixed income investments (e.g. bonds) may not be able to meet interest payments nor repay the money they have borrowed. The worse the credit quality of the issuer, the greater the risk of default and therefore investment loss. Derivatives: The use of derivatives may increase overall risk by magnifying the effect of both gains and losses leading to large changes in value and potentially large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss. Emerging market: These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems. 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. Interest rate: The value of fixed income investments (e.g. bonds) tends to decrease when interest rates rise.