**Rathbone Unit Trust Management**

**Contact us** 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

# Rathbone UK Opportunities Fund

## Monthly update October 2022

The second half of October brought very welcome relief from the embarrassing circus that had engulfed UK politics in recent months. We had some sympathy with Liz Truss and Kwasi Kwarteng's ambitions to increase productivity and investment in the UK, but the timing, communication and method of funding these goals were less than acceptable. Markets voted with their feet, with sterling and mid-caps bearing the brunt of selling pressure. Outflows from UK equity markets reached record levels. For the first time in this bear market, we got a real taste of investor revulsion. Nasty, but a necessary step for moving on.

**Political reset starts to erode the uncertainty risk premium**

More normal service has been resumed with the appointment of Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Investors approve of their approach to fiscal probity, kicking off with an almost complete reversal of the mini-budget. The dynamic was good for markets and great for the performance of your fund. Sterling appreciated, bond yields fell back and mid-caps bounced hardest. Gas prices have fallen back aggressively too. But the outlook for consumers remains tough, with tax hikes and lower government spending on the cards, alongside higher interest rates to combat persistent inflation. It won't be an easy ride for companies over the next 12 months or so either. But, at the very least, some political stability and credibility is returning. The Autumn Statement on 17 November will be a crucial driver of global sentiment towards UK assets. Interestingly, your fund has already seen inflows start to pick up.

**How will a slowing economy impact earnings?**

Right now, markets are obsessed with interest rates: when will central banks pause the hiking cycle or even begin to cut? This is the main driver of market moves. But investors also need to consider how the economic slowdown that central banks are determined to cause will impact earnings. We haven't yet seen much economic damage from sharp policy tightening. But, as recession bites, we will undoubtedly see more companies issuing profit warnings (they've mainly been driven by higher costs to date, weaker demand could be the next shoe to drop). The big question, of course, is to what extent is all this priced in?

The answer depends on where you look. US equities still look like a crowded trade, with still-high earnings expectations and punchy valuation multiples for this point in the cycle. European and UK stocks have gone quite a long way to price in the impact of an (admittedly worse-looking) downturn. For the UK in particular, with incredibly depressed valuations and a more credible government in place, we see a path for businesses to trade through incremental bad news. Quality (think low leverage and high profit margins) should remain the watchword to sidestep the worst of the coming downgrades.

This commentary has become increasingly macro-focused of late. But it's stock-picking that's our day job (and, indeed, our passion). Our top performer this month was industrial components company **discoverIE** which continued to outperform even our lofty expectations thanks to growth in its preferred end-markets, including renewables and life sciences. We have long admired the skill and confidence of its CEO. Importantly, this view is backed up by the numbers it delivers. A couple of our tech names were the biggest detractors: identification software developer **GB Group** and business software supplier **Bytes** both issued numbers that slightly missed the mark. It's instructive that even after a tough year (Bytes, for example, had already fallen 25% this year), companies that fall short of expectations on numbers day are still getting heavily punished. This trend needs to fade before we feel comfortable that the bottom of the market is firmly in. We didn't add any new holdings this month, but we've seen lots of companies in the last few months and expect to make some moves shortly.

**Alexandra Jackson**
Fund Manager

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**Rathbone Unit Trust Management Limited**
8 Finsbury Circus, London EC2M 7AZ
Tel 020 7399 0000

**Information line**
020 7399 0399
rutm@rathbones.com
rathbonefunds.com

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