RATHBONES

RATHBONE UK OPPORTUNITIES FUND

QUARTERLY UPDATE MARCH 2024

The first quarter of 2024 seems to have flown by in equity markets. UK assets, particularly mid-caps, had a tricky start to the year after a storming rally in November and December driven by falling bond yields. The UK 10-year government bond yield reached 3.4% before year-end, which clearly was a touch too aggressive given the Bank of England (BoE) may not cut rates until June this year. This realisation duly arrived in the first quarter, and yields backed up again to 4%. Since quarter-end, they have jumped further, above 4.1%. Interest rates are an important factor in valuing assets, so equities have struggled to move ahead.

Central bank rate movements and associated bond yield changes are still the major drivers of markets, although company results have latterly made their mark too. Overall, the first two months of the year felt a bit like Groundhog Day: UK equities failing to make headway yet US markets continuing to rally, driven by the tech-led Magnificent Seven.

March was different though; the FTSE 100 and FTSE 250 not only kept up with US (and European) stocks, but in sterling terms outperformed them. The catalyst was the BoE monetary policy meeting where one member voted to cut rates, and none voted to hike. Investors can now be confident that, all else being equal, the next move in UK rates is down. Rapidly falling inflation prints reinforce this, while the labour market remains decent, suggesting the softest of landings.

UK 'growth' at 'value' prices

The catalyst was clear, but we think the setup is important too: the UK market trades on a record discount to the US, yet no longer looks like an economic outlier. With the Magnificent Seven driving such narrow returns, it makes sense that investors are increasingly looking for some alternatives for fresh capital. Buying 'quality growth' businesses trading at prices that are a 'value' multiple of earnings in a stable economy could look like a good choice (and we discuss a few of them below). Indeed, we hear more market commentators, with no axe to grind, talking up the UK, particularly mid-caps. We are, of course, in violent agreement.

While the UK hasn't shared the tremendous outperformance of the US stock market, it has shared its top-heavy concentration of returns. Fully 40% of the FTSE All-Share Index is made up of the 10 largest stocks. For recent context, in March, 30% of the index's return came from one stock: oil giant Shell (which we don't own). We think there's lots of value lurking below the surface here in Britain, yet investor attention has been squarely elsewhere. We think that situation must change at some point. While no silver bullet, the British ISA that was announced at the Spring Budget is a nice, simple first step.

Performance review

	3 months	6 months	1 year	3 years	5 years
Rathbone UK Opportunities Fund	0.9%	10.4%	6.7%	-7.6%	17.5%
IA UK All Companies Sector	2.9%	7.5%	7.7%	11.3%	24.2%
FTSE All-Share Index	3.6%	6.9%	8.4%	26.1%	30.3%

	31 Mar 23-31 Mar 24	31 Mar 22-31 Mar 23	31 Mar 21-31 Mar 22	31 Mar 20-31 Mar 21	31 Mar 19-31 Mar 20
Rathbone UK Opportunities Fund	6.7%	-13.1%	-0.4%	45.9%	-12.9%
IA UK All Companies Sector	7.7%	-1.9%	5.4%	38.0%	-19.2%
FTSE All-Share Index	8.4%	2.9%	13.0%	26.7%	-18.5%

Source: FE Analytics; data to 31 March, I-class, mid price to mid price.

These figures refer to past performance, which isn't a reliable indicator of future returns.

Our top contributor to March returns was also the biggest negative contributor over the quarter. **JD Sports** warned in January about a lack of exciting new products and discounting in the athleisure market hitting profits. But its recent results suggest things have stabilised, with the new chief financial officer getting the house back in order. Trading at under 10x next year's earnings, we think the stock can perform well as investors regain confidence in both this management team and the outlook for its biggest supplier, Nike. Over half of JD's global sales come from Nike products. The over £1 billion of cash sitting on the balance sheet gives heft and security to this business operating in a tough retail environment.

Large-cap holdings construction supplier **CRH** and alternatives asset manager **Intermediate Capital** remain at the top of the leader board for the quarter. We've trimmed CRH to keep within our position limits (5% for large caps, 3% for smaller companies), but we like the longer-term outlook for US infrastructure spending. We're happy to see Intermediate Capital starting to re-rate towards its Swiss-listed peer Partners Group, although the gap remains too wide in our opinion (Intermediate Capital on 13x versus Partners on 26x).

Counterintuitively, our tech positions performed poorly over the month and the quarter. Software consultant **Kainos** has an optically high valuation, which we think is warranted by its high margins and sales growth, but growth could be a little softer than normal this year thanks to the pre-election 'purdah' (it does a lot of business with government departments) and temporarily higher competition from larger, general purpose consultants looking to offset weakness in its usual markets. Outsourced video game developer **Keywords Studios** remains in the doldrums despite issuing strong numbers, due to an overplayed threat from AI. Management actually see AI as a volume driver for their business over time, and in the near term have been clear they are not seeing any pricing and revenue headwinds. The stock trades on 11x for 10% expected earnings growth. But we are conscious sentiment may take time to improve in this name.

We are surprised our tech names are under pressure, as we are picking up signals that IT spending is on the increase. And not just for defensive products like cybersecurity. Increasingly, management teams are asking their software partners 'what will help us grow?' Another top contributor this month, industrial component maker **discoverIE**, has recently commented that organic orders and sales have recently turned positive for the first time in 18 months. DiscoverIE makes electronic components for industrial machines ranging across many different industries. That may mean companies are starting to invest in new plant and equipment once more.

These are the hints of a new cycle.

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For more info on our fund, including factsheets, performance and fund manager views, please click here.

If you require further clarification on this commentary, then please contact your adviser or Rathbones at the contact details below.

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