Review

July, in many ways, was a very similar month to June in the sense that, at the headline level, the market was relatively becalmed, with the MSCI UK Index gaining a modest +0.3%. However, beneath the surface, substantial volatility persisted throughout the month. The first half of July continued the theme of significant rotation away from cyclical and reflationary stocks towards more defensive and growth orientated companies, with the latter half of the month seeing a modest reversal in these trends.

The dominant themes of the month remained the same, principally the ongoing debate over inflation and whether or not the current bout will prove persistent or transitory, and the Covid-19 pandemic and specifically the likely impact on growth expectations as the 'delta' variant spreads inevitably around the world. An additional issue capturing investor attention during the month was significant weakness in Chinese asset markets amid a perceived crackdown on overseas influence on Chinese companies.

Elsewhere, despite somewhat mixed messaging from various Federal Reserve board members, Chairman Powell continued to insist that the Fed are in absolutely no rush to remove stimulus despite the strengthening US economy. Meanwhile, earnings season got underway in earnest and, thus far, reports have generally remained extremely positive.

Here in the UK, 'Freedom Day' duly arrived, although anecdotally there has not yet been a major uplift in underlying activity levels as a consequence. However, perhaps more significantly, and despite numerous warnings to the contrary, the latest wave of the Covid-19 pandemic appears to have already peaked and is now declining fairly rapidly. Should that remain the case, despite the relaxing of restrictions, that should give grounds for optimism that no further lockdowns will be required and the pandemic, in the UK at least, is potentially coming to an end.

Fund performance / Activity

It was another disappointing month in terms of performance for the fund as the market continued to rotate away from cyclical and reflationary stocks. The fund fell -1.6% (share class A GBP Net Accumulation), underperforming the peer group average gain of +0.9% and the MSCI UK Index gain of +0.3%.

There was one individual stand out negative contributor during the month, namely Micro Focus. The company is in the process of executing a complex turnaround following several problematic years post an ill-fated acquisition in the US. The latest results confirmed continued progress in that regard, although not perhaps to the extent the market was hoping for at this stage. The resulting significant fall in the share price, whilst frustrating, does not diminish our enthusiasm for the eventual upside potential in the shares.

Elsewhere, a number of our cyclical holdings contributed negatively including ITV, Marks & Spencer, Standard Chartered and WPP. Having no exposure to several large companies that performed relatively strongly during the month, including Experian, Relx and Anglo American also proved detrimental.

Positive attribution came from a variety of holdings including Bodycote, OSB Group, National Express and BHP Group. Having no exposure to index heavyweights HSBC, AstraZeneca and Unilever also proved relatively favourable.

There was a little more portfolio activity during July. We added 1 new holding in the shape of NatWest Group. We took advantage of continued share price weakness to add to several of our core holdings including ITV, Prudential, WH Smith, JD Wetherspoon and WPP.

These additions were funded by 2 complete disposals of Entain and Intermediate Capital. Both are companies that have performed exceptionally well for the fund, but where we now feel there are better capital deployment opportunities elsewhere. We also took profits in DS Smith, Vistry and Bodycote.

Market Outlook

We do not really have anything new to add this month from previous outlook comments. Markets, in our view, have been operating with a cautious/defensive bias for a couple of months now, and that has been reflected in the near-term performance of our portfolio.

The primary concerns are well understood, namely the impact of the ongoing Covid-19 pandemic, the persistence or otherwise of current elevated inflation readings, the eventual need to withdraw ultra-easy policy support and, more recently, what does the significant decline in bond yields around the world signify.

Notwithstanding these concerns, our view remains that we are in the relatively early stages of the post-pandemic recovery period. Economic activity still has substantial room to rebound as economies gradually reopen around the world, corporate profitability, as can be seen from the latest earnings season, continues to recover strongly and policy, whilst eventually needing to be tightened, remains very accommodative and will likely be so for a substantial period to come.

Concerning our portfolio holdings, we repeat our comments from last month, specifically we remain extremely optimistic on the medium-term outlook for significant further progress. In a great many cases we view our holdings as being roughly one year into a multi-year recovery process. Of course, there will be bumps along the way, but the medium-term upside still looks exceptional to us and, as such, we are happy to keep the exposures we currently have, and indeed we remain comfortable utilising any near term weakness to add to favoured positions.

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Data source (unless otherwise stated): Bloomberg, FE Analytics

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