SARASIN
UK THEMATIC SMALLER COMPANIES

SARASIN & PARTNERS

ECONOMIC AND FUND REVIEW

UK equities lagged behind other regions during the third quarter, extending their year-to-date losses and underperformance of global equity markets. Renewed fears around a disorderly Brexit weighed on sentiment, as did worries towards the end of the period around the implications of a second wave in COVID-19 infections. While GDP figures showed the economy rebounding from the big drop seen in the previous quarter, the recovery has begun to slow as the fiscal stimulus fades and the unemployment numbers rise. The current environment is also influencing expectations of Bank of England policy, with the market pricing in the chance of negative interest rates at some point in 2021.

Within the portfolios some of the more defensive consumer products names maintained their outperformance from the previous quarter before a shift in the market as investors turned their attention towards recovery cyclicals. Online shopping platform, Ocado, continued to do well as the growth in online grocery shopping accelerated. Unilever also did well due to the sustained demand for food, drink and household products for the home. Later in the quarter, a number of the more cyclical names that had been hit hard began to rally, led by 3i Group, the owner of a European non-food retail chain that that saw a significant recovery as restrictions were lifted. The big hotel chain, IHG, the testing and inspection group, Intertek and the engineering company, IMI, all benefitted, in particular, from the re-opening of China where each has a strong presence.

The holdings in the financial sector all detracted from the portfolio. The banks, HSBC and Lloyds, were particularly weak on lower than expected profits and higher loan loss provisions, due to the uncertain macroeconomic environment. The lack of visibility around when they might be able to pay a dividend only added to the pressure on the shares. The large insurance groups, Legal & General and Prudential, did not fare much better for many of the same reasons as the banks. Other negative contributors included Vodafone and DS Smith on weaker numbers and similar dividend concerns.

No new names were added or existing holdings sold from the portfolio during the quarter.

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OUTLOOK

In the immediate future the key driver for the UK equity market will be the final outcome of the current Brexit negotiations. Discussions have been complicated by the UK government's drafting of the Internal Market Bill which is seeking to alter the terms of trade between the UK and Northern Ireland as agreed under the EU withdrawal agreement. While we believe a limited free trade agreement still remains the most likely scenario the risk of a more adverse outcome is rising. The uncertainty will likely continue to weigh on both sterling and the market until a resolution is found.

We are hopeful that there will be positive news on a vaccine in the coming months but in the immediate future the tightening of restrictions in the battle against Covid-19 looks set to continue. This will further push out any form of sustained recovery in GDP, while the outlook for unemployment looks increasingly bleak as the support from the furlough scheme slowly falls away. Many companies, particularly in the travel and hospitality sectors, are facing uncertain futures as profits disappear and debts rise. Companies in other sectors have fared better and some have even resumed guidance on their likely financial performance for the rest of 2020 and others, where appropriate, have resumed the payment of dividends that they had deferred in the spring.

Looking forward, those companies with greater visibility in such an uncertain environment and those with strong balance sheets will emerge as the winners. Our focus in the portfolios is on solid companies that are in the position to generate secure and growing cashflows and that benefit from long-term structural growth themes. Despite weak UK growth leaving many companies struggling over the shorter term, we see good opportunities in the UK market over the longer term.

Important Information

Prior to 15th October 2020, the fund was named Sarasin UK Equity. Prior to 28th November 2016, the fund was named Sarasin EquiSar - UK Thematic.

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There is no minimum investment period, though we would recommend that you view your investment as a medium to long term one (i.e. 5 to 10 years). The investments of the fund are subject to normal market fluctuations. **The value of the investments of the fund and the income from them can fall as well as rise and investors may not get back the amount originally invested.** If investing in foreign currencies, the return in the investor's reference currency may increase or decrease as a result of currency fluctuations. **Past performance is not a guide to future returns and may not be repeated.**

For efficient portfolio management the Fund may invest in derivatives. The value of these investments may fluctuate significantly, but the overall intention of the use of derivative techniques is to reduce volatility of returns. The Fund may also invest in derivatives for investment purposes.

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