SARASIN UK THEMATIC SMALLER COMPANIES FUND

SARASIN & PARTNERS

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ECONOMIC AND FUND REVIEW

After a positive 2021, the first quarter of 2022 has been more difficult for the UK equity market. Concerns over the economic implications of the Russian invasion of Ukraine and the need for interest rate rises to combat higher inflation have weighed on market sentiment.

The conflict has pushed energy and commodity prices to extreme levels, leading to a surge in inflation, supply chain disruption and the prospect of lower economic growth. In response, the Bank of England has raised interest rates to 0.75%. The Chancellor also announced a fiscal package aimed at supporting household incomes in the face of a significant purchasing power squeeze. Despite this, the UK labour market continues to show strong growth, and the latest purchasing managers' indices business survey was better than expected. The economy is clearly still growing despite the challenges. Consumer confidence, however, has fallen sharply.

The MSCI UK Small Cap Index fell 11.6% during the quarter. This was significantly worse than the core large-cap index, which was supported by the strong performance of the oil majors and commodity conglomerates. While these sectors performed well within the small-cap index as well, they are a far smaller constituent of the market. Utilities and real estate also held up well, although the fund's exposure to these sectors is minimal. The higher-growth and thematic sectors such as healthcare, information technology (IT) and consumer discretionary fell in value, underperforming more value-orientated industrials and financials stocks.

The portfolio benefitted from strong stock selection within the consumer, communication services and IT sectors. This helped to offset our overweight positions – relative to the benchmark – in the weaker parts of the market. Cranswick, WH Smith and SSP, in particular, benefitted from both the economy and travel rebounding strongly after the worst effects of the pandemic. YouGov and Learning Technologies Group also performed well.

In contrast, the portfolio's large exposure to poorly performing healthcare stocks detracted from performance. Most notably these included Oxford Biomedica and Oxford Nanopore. Within the industrials sector, holdings in RWS and IMI weighed on returns.

Over the quarter we sold Clinigen and Pennon, among others, while we added Kainos and Johnson Services Group to the portfolio.

OUTLOOK

The UK market had plenty to worry about before Russia's invasion of Ukraine. This included monetary tightening, the continued impact of the pandemic on global supply chains, rising interest rates and inflation. The invasion only adds to the near-term risks, with the immediate threat coming from rising energy and food prices. Economic growth in the UK is likely to moderate from last year's post-lockdown surge. Elevated inflation will also weigh on consumers and increase wage pressures. This uncertainty is likely to have an impact on equities and increase market volatility.

Despite this backdrop, some companies are benefitting from a strong rebound in earnings following the pandemic. Many have also successfully adapted and used the pandemic as an opportunity to strengthen their balance sheets. This will provide opportunities, particularly for those with pricing power, to combat rising inflation. Many have surplus cash and are in a good position to invest back into their businesses. This includes making acquisitions, paying down debt, buying back shares and distributing more to investors via dividends.

Attractive valuations and dividend yields may now begin to encourage global investors to return to the market. Various sectors and individual companies that benefit from supportive longer-term thematic factors now appear attractively valued. We remain focused on these areas of the market and on companies expected to emerge in a stronger competitive position. Such companies can generate reliable and growing cashflows over the long term.

IMPORTANT INFORMATION

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Prior to 15th October 2020, the fund was named Sarasin UK Equity.

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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.**

The Fund may invest in smaller company shares which can be more unpredictable and less liquid than those of larger company shares. Frequent political and social unrest in Emerging Markets, and the high inflation and interest rates this tends to encourage, may lead to sharp swings in foreign currency markets and stock markets. There is also an inherent risk in the smaller size of many Emerging Markets, especially since this means restricted liquidity. Further risks to bear in mind are restrictions on foreigners making currency transactions or investments.

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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