

Rathbone UK Opportunities Fund

Monthly update October 2023

October cemented its reputation as a tough month for investors, offering the worst performance of the year for the FTSE 250 Index. Higher bond yields and the awful situation in the Middle East weighed heavily. Third-quarter results were underwhelming at best, reminding investors what a growth slowdown looks like. There are signs that consumers are pulling back on spending and that corporates are taking longer to make decisions. At the same time, yields spiked higher again as investors fretted about the US government's fiscal position. Combined, this made for a nasty dynamic for equities.

Slowdown concerns are dominant

Defensive names were the relative outperformers, as you'd expect when investors try to price in a slowdown. Our large-cap resilient stocks like supermarket chain **Tesco** and drinks company **Diageo** were among our top contributors, alongside oil services business **Ashtead Technology**, and ID verification company **GB Group** bounced off lows after holding its profit forecasts steady for the first time in a while. We think Ashtead Tech is in something of a sweet spot, renting out subsea servicing equipment to the oil and gas sector. The shares look attractively valued on a 15x price/earnings multiple for 10% earnings growth and the business has consistently upgraded earnings expectations since floating, while still remaining well under most investors' radar.

Poor performance came from retailer **JD Sports**, UK property platform **Rightmove** and IT outsourcer **Softcat**. JD issued an excellent set of numbers, defying the negative commentary that its US peers had previously put out. We are hugely impressed by the actions of the new CEO so far: selling non-core areas and working through a mountain of previous accounting adjustments. Such good earnings momentum is consistently met with a shrug as investors worry about consumer spending. We think the valuation more than compensates for such worries, while the actual delivery is superb.

Rightmove is facing a new competitor in its home market, as US-listed property portal CoStar made a £100 million offer for the number three player in the UK residential market, OnTheMarket. CoStar plans to spend hundreds of millions pounds on pay-per-click advertising to try to unseat Rightmove, including nearly £50m in the first year. While this amount of investment could certainly drive property hunters to use the OnTheMarket website, if they don't find the critical mass of properties there that Rightmove have, the money is wasted. Rightmove doesn't spend a single pound on pay-per-click advertising, and yet it gets 80% of all eyeballs nonetheless. We've watched Rightmove see off deep-pocketed competitors – most notably Google – before, so we appreciate the strength of the moat around this business. That's not to say management aren't laser focused on this new threat, and we expect to hear more about Rightmove's response later in November.

Softcat, the IT software and hardware reseller, spooked the market a little by commenting that businesses are taking a bit longer to make decisions around IT spending at the moment. Given the stock trades on a high rating, and the market was in no mood to give the benefit of the doubt, the shares took a hit. They've since started rallying back.

After October's heavy sell-off, the forward earnings multiple for the FTSE 250 was below that of the FTSE 100. This is a rare sight – something only seen three times in the last 20 years. And on average, after this cross-over, the junior index outperforms by an average of 10% over the next 12 months.

As some of the issues that have weighed on smaller companies of late reverse or simply peak, we envisage investors will reappraise this asset class. The most pressing is whether or not interest rates have finished rising. Additional support could come from the mooted launch of the Great British ISA, a rumoured £10,000 allowance for investing in UK companies. While there's been a distinct lack of appetite for UK assets lately, given valuations and fundamentals, there's certainly no lack of opportunity.



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