Marlborough
Fund Managers

Marlborough UK Multi-Cap Growth: investing in a portfolio of the UK's leading companies

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"The sell-off has provided an opportunity to buy high quality companies at attractive valuations."

Richard Hallett

The **Marlborough UK Multi-Cap Growth Fund** invests in a portfolio of leading companies from across the market cap spectrum that can demonstrate a sustainable competitive advantage. Here the fund's manager, Richard Hallett, talks about the investment outlook and opportunities created by last year's sell-off.

How would you describe the investment outlook for the UK and globally?

"After several years of steady upward progress, we had the market sell off that began in October. While it's difficult to pinpoint the exact cause, investors have been concerned about US/China trade tensions and that rising US interest rates will dampen economic growth. In addition, there have been anxieties about slowing international economic growth, particularly in China, with global giants like Apple and Caterpillar reporting weaker demand for their products.

"In the UK, the equity market has had to contend with the additional complexity of Brexit, which has held back business investment and consumer spending, while also prompting international investors to reduce their UK exposure.

"Looking ahead now though, over the next few months the uncertainty around Brexit should come to some sort of conclusion and we expect a clearer picture to emerge about the position with US/China trade and tariffs.

"It's worth making the point too that economists are still predicting a healthy global growth rate of around 3% in 2019. The US is still growing nicely and all-important indicators from small businesses indicate their economy is in robust health. As for China, while GDP growth has slowed, it's still over 6% and they're continuing to buy commodities like copper and iron ore in high volumes.

"So, it's a mixed picture and there are undoubtedly challenges at a global level and for the UK specifically. As investors though, it's important not to let this obscure the fact that there are still many UK businesses trading very successfully and growing strongly.

"With equity markets now on lower valuations and a seemingly more dovish stance from the US Federal Reserve on interest rates,

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positive news could begin to push markets higher again. We believe that for investors looking to the medium term there are very interesting opportunities at the moment."

Against that backdrop, how does the outlook look for companies in your portfolio?

"One of the key points about the fund is that while we pay close attention to the macroeconomic backdrop, we don't make investments based on forecasts about it - because they're so difficult to get right consistently.

"Instead we look for companies that we believe can carry on growing regardless of the wider economic backdrop - and I think the current uncertain environment underlines the advantages of that approach.

"In selecting companies for the portfolio, we have pretty exacting criteria. We're looking for businesses that have a sustainable competitive advantage, that are leaders in a niche business area with few competitors and that are benefiting from an established long-term structural growth trend.

"What's been interesting is that while the markets were selling off, our portfolio companies were continuing to report positive trading updates. We hold 44 companies and over the last quarter period 40 issued updates that were in line with, or surpassed, forecasts, while only 3 reported negative news.

"Given the uncertainty facing the UK, it's also worth noting the global nature of many of the UK-listed companies in our portfolio. We took a decision to increase international exposure after the Brexit vote and around 80% of the underlying earnings of our portfolio companies now come from overseas markets."

Given your focus on quality 'all weather' performers, why did portfolio companies sell-off during October's correction?

"We invest in companies that are leaders in their fields and which we believe can continue growing their earnings throughout the business cycle. The quality nature of these businesses does mean though that they're often on higher valuations than more cyclical stocks. When we have a market correction and investors are nervous what tends to happen is that they'll look at how well stocks like these have done and try to lock in some of those gains. So, we view it as short-term profit-taking.

"Taking a longer view though, as we do, we believe the investment case remains strong for these companies. Their potential to grow their earnings consistently over the years ahead and to do that without relying on a macroeconomic tailwind makes them an attractive proposition for investors.

"What the across-the-board nature of the sell-off has done is to provide opportunities to buy many of these companies at lower prices. We've taken advantage of this and added to a number of our positions."

Were there any companies that were particularly hard hit?

"Over and above the broad sell-off, there have been stocks in our portfolio like Blue Prism and Craneware whose share prices fell particularly sharply, but which we continue to believe are strong businesses with excellent growth potential.

"Blue Prism is a leading global player in the field of robotic process automation, where software 'robots' handle repetitive back-office administrative tasks such as transferring data between different computer applications.

"Its share price has pretty much halved, despite positive trading updates and upgrades to earnings estimates. The stock was highly rated, and taking a long term view, we think the fundamentals have actually improved considerably, with a recent £100m fund raising that will enable the company to accelerate investment and ensure it retains its market position in this high-growth sector. So, we've been adding to our holding at these lower prices.

"Craneware provides software for the US healthcare industry and is the leading player in its field. Its shares had fallen by around 40% at one stage and we took the opportunity to add to our position. Since then the company has issued a positive trading statement and the share price has rallied.

"We've seen good quality companies we hold fall sharply before and then bounce back strongly. Homeserve is a good example. It ran into trouble with the regulator in 2011 over sales practices and the share price fell from close to £5 to less than £1.50. But the company addressed the issues and the share price recovered. Today it's well over £9."

Are there sectors you are avoiding at the moment and any areas where you are seeing particular opportunities?

"We continue to avoid sectors including utilities, tobacco, property and telecoms, where we believe there are structural weaknesses that limit their attractiveness over the longer term.

"In terms of opportunities, the main one for us has been the chance to add to high quality companies we already hold at more attractive valuations following the sell-off.

"We've bought more Prudential, the global financial services business, which is achieving particularly strong growth in Asia, where it's benefiting from the rise of the middle class, who are increasingly interested in insurance and savings products.

"We've also added to Genus, which is an agricultural breeding company with a portfolio of high-quality pigs and cows that's in demand with farmers around the world, particularly in emerging markets.

"Another company we've been buying more of is Burford Capital. Their profits are based on the success of litigation claims that they part finance. These earnings are pretty much uncorrelated to economic growth because whatever's happening in the economy there's still litigation. Indeed, it may be that in more challenging economic conditions you have more companies suing each other.

"Overall, I think the key message is that while there's no doubt the UK faces challenges, there are still plenty of UK companies trading well and growing strongly, particularly those benefiting from long-term structural growth trends. The recent sell-off has provided an opportunity to add to these stocks at more attractive prices."

Risk Warnings

Capital is at risk. The fund holds some or all of the stocks mentioned in this article. The value and income from investments can go down as well as up and are not guaranteed. An investor may get back significantly less than they invest. Past performance is not a reliable indicator of current or future performance and should not be the sole factor considered when selecting funds. Our funds invest for the long-term and may not be appropriate for investors who plan to take money out within five years. Tax treatment depends on individual circumstances and may change in the future.The fund will be exposed to stock markets. Stock market prices can move irrationally and be affected unpredictably by diverse factors, including political and economic events.The fund invests mainly in the UK, therefore, investments will be vulnerable to sentiment in that market, which may strongly affect the value of the fund.

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