LIONTRUST

GLOBAL EQUITY

Liontrust Income Fund

Q2 2022 review

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The Liontrust Income Fund returned -7.0% in the second quarter of 2022, marginally behind the -5.5% of the IA UK Equity Income sector and the -5.0% of the FTSE All Share Index (both comparator benchmarks). This placed the fund in the 3rd quartile for the quarter, though it remains in the 2nd quartile on a rolling 1-year basis, and top quartile on a 5-year basis*.

Much of the turbulence that we saw in Q1 continued throughout the second quarter of 2022. Economic growth in the UK, and indeed around the world, continued to face headwinds from a long tail of Covid outbreaks and the ongoing Russian invasion of Ukraine. In addition to increasing economic uncertainty, these factors served to exacerbate existing supply chain issues and increase inflationary pressures − further intensifying a cost-of-living crisis in the UK as real incomes continued to fall to multi-decade lows. Economic uncertainty spilled over to the commodities markets, where global metals – notably copper – took a dramatic fall from their March highs on heightened recession fears as well as concerns about Chinese industrial demand as the nation continues to pursue a zero-Covid strategy.

UK Inflation hit a four-decade high of 9.08% (CPI) in May, primarily driven by higher food and energy prices, and is projected to hit 11% by year end. As a result, the Bank of England continued to hike interest rates over the period, increasing the Bank Rate by 25 basis points in each of their May and June meetings to take it to 1.25%. This rate hike program is expected to continue throughout the year and into 2023.

GDP growth for May, meanwhile, came in a touch ahead of expectations growing 0.5% month-on-month, having contracted in April by 0.2%. GDP in the UK is now 1.7% above its pre-pandemic levels, with recent growth driven by a strong gain in industrial production and services, notably in health services which were bolstered by a 15% increase in GP appointments in England following the suspension of the UK test-and-trace program in April. Meanwhile, wholesale and retail trade contracted by 0.8%, despite travel agencies and tour operators expanding by a robust 11%, suggesting households have been cutting back on discretionary spending but not on summer travel. The downside of this pent-up travel demand being realised has been significant disruption at airports as travel operators have struggled to find enough personnel to cope with a V-shaped recovery against an ongoing Covid backdrop.

A backdrop of cost-of-living related industry-wide strike-action and political skullduggery fortunately did relatively little to unsettle the UK markets, though sterling proved less resilient, particularly against the US dollar where it dipped below the 1.20 mark for the first time since the 1980s.

In spite of, or perhaps due to, the turbulent global backdrop, the UK market managed to outperform other global markets over the period, bolstered by the FTSE 100 Index which fell just 3.8% in Q2 on a total return basis and strongly outperformed the FTSE 250 (-11%) and FTSE Small Cap (-9.5%) indices.

In aggregate, the entirety of the FTSE grouping managed to outperform other global indices, notably MSCI World (-16.1%), the S&P 500 (-16.1%), the NASDAQ 100 (-22.3%), and the European STOXX 50 (-9.4%). This global sell-off was largely driven by multiple-contraction in growth stocks as central banks around the world hiked interest rates to combat persistent and increasingly high inflation, or proximity to the war in Ukraine in the instance of the STOXX index.

Despite the headwind of materials and mining exposure, the FTSE 100, being less exposed to such growth names, fared relatively well, especially versus the tech-heavy NASDAQ. Compared to the smaller-cap FTSE indices, the larger-cap constituents also benefited from international exposure (non-sterling earnings) and economies of scale, as they have been better able to manage inflation through investment, cost controls, and superior insight and influence over supply-chains. Rallies in stock-specific names further bolstered the FTSE 100 over the quarter, notably BAE Systems which benefited from increased European defense spend prospects.

Despite this top-end rally, UK stocks remain cheap relative to peers with the FTSE 100 trading on 9.9 times forward earnings multiple at end of Q2 (compared to 10.9 times for the Euro STOXX 50, 16.6 times for the S&P500, and 20.7 times for the growth-heavy NASDAQ 100). From an income perspective, the UK continued its 2021 trend of companies reinstating dividends that had been cancelled or suspended throughout 2020.

On a sector basis, industrials was the greatest contributor to Fund performance in the quarter. Whilst the Fund remains marginally underweight in industrials, it benefitted from wider downturn in the industrial space as well as an overweight position in defense company BAE systems which gained over 16% in the quarter as the Russian invasion of Ukraine continued to spur increased sentiments around defense spend budgets across Europe.

Meanwhile, in the materials space, the Fund benefited from overweight position in Johnson Matthey, which delivered a solid set of results indicating that their updated strategy (led by a new CEO) which focuses on a simplified portfolio structure and reliable dividend has been well received by investors.

On the flipside, our overweight position to technology was a key Q2 detractor on a sector basis. These positions fell as rising inflation and subsequent interest rates saw investors rotate out of traditional growth stocks. Another key detractor was our overweight exposure to the materials sector, notably our mining exposure − a key driver of performance in Q1, these stocks significantly underperformed in Q2 as metals prices declined. Copper miner Antofagasta was the single greatest detractor in the Fund for the period, facing headwinds on both broader macro (copper price decline) and more idiosyncratic (Chilean constitutional reform increasing regulatory risk) bases.

The Fund’s overweight exposure to financials also proved a detractor as increasing inflationary and recessionary risk weighed on the sector, and we chose to exit one of our key detracting positions – abrdn plc – during the period.

Despite the roll-off in the prices of many commodities, inflation continues to rise and is expected to surpass 11% in Q4 once the UK's energy regulator increases its energy price cap by a projected 42%. Given this inflationary backdrop, we continue to focus on companies who can pass on costs, as well as mitigate input costs through economies of scale and cost management efficiencies.

In response to this inflation outlook, the BOE is expected to continue with their program of hiking interest rates, having hiked rates 4 times already this year. The market is currently pricing in slightly over 6 rate hikes for the year, with money markets pricing in a potential 50bp raise in August and rates reaching 3% by March of 2023. However, given a new Prime Ministerial race and the geo-political uncertainty that has been evident since the start of the year with the Russia/Ukraine war, the BOE is cognizant of balancing the need to rein in inflation versus the need to support economic growth.

In a rising rate environment where returns are less driven by multiple expansion, dividends are becoming a growing contributor to shareholder returns. The UK's status as a superior hunting ground for dividends (which are projected to continue their trend steady growth trend) thus looks set to boost its attractiveness to investors feeling the squeeze from rising rates across global markets.

Finally, whilst a change in Tory leadership (and thus a new British Prime Minister) is not likely to be a key factor driving the market, it has potential implications for a variety of factors such as fiscal policy and sterling strength – the latter which may see an improvement from more stable leadership. Nonetheless, this is not something that we expect to have a significant impact on the UK equity market, though we are wary of second- and third-order impacts which may unfold over time.

Discrete years' performance (%), to previous quarter-end:**

	Jun-22	Jun-21	Jun-20	Jun-19	Jun-18
Liontrust Income C Acc	0.7%	19.0%	-13.1%	6.5%	9.6%
FTSE All Share	1.6%	21.5%	-13.0%	0.6%	9.0%
IA UK Equity Income	-0.3%	25.4%	-13.6%	-2.5%	6.0%
Quartile	2	4	2	1	1

***Source: FE Analytics as at 30.06.22**

****Source: FE Analytics as at 30.06.22. Quartiles generated on 06.07.22**

For a comprehensive list of common financial words and terms, see our glossary at: https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms

Key Risks

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

Investment in the Fund involves foreign currencies and may be subject to fluctuations in value due to movements in exchange rates. The value of fixed income securities will fall if the issuer is unable to repay its debt or has its credit rating reduced. Generally, the higher the perceived credit risk of the issuer, the higher the rate of interest. Bond markets may be subject to reduced liquidity. The Fund may invest in emerging markets/soft currencies or in financial derivative instruments, both of which may have the effect of increasing volatility.

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