Income Fund Commentary – Q4 2023

- **Fund Net Return:**

  Past Performance does not predict future returns

Fund: Liontrust Income Fund	Benchmark: FTSE All-Share Index
Q4: 3.7%	**Q4: 3.2%**

Source: Liontrust, as at 29 December 2023. Share Class C Acc, Net of Fees, GBP.

- **Performance Drivers Summary:**

The Fund outperformed its target benchmark over Q4. October was a torrid month for the fund and markets, with geopolitical issues in the Middle East exploding to the fore and government bond yields reaching a 16 year high. However, markets rebounded in November, despite ongoing macro uncertainty. December was also a strong month, with equity markets rallying post the 'Fed Pivot' early in the month.

UK equities were strong in Q4, in particular, UK small cap and mid-cap indices which outperformed the broader market. This was due in part to a growing focus on domestic companies, combined with the hope that interest rates had finally reached their peak. There was also renewed interest in UK businesses from outside the UK. However, the picture was more mixed for larger companies, with strong sterling and a weak US dollar restraining growth for some firms.

UK inflation continued to fall over the period, more sharply than many had expected. Meanwhile UK GDP rose 0.3% in November 2023, following a 0.3% drop in October. Fears of recession have weighed on markets for some time, but the UK economy has performed better than expected so far.

From a sector perspective, an overweight exposure to industrials and underweight to financials were the most supportive of the Fund's performance but an overweight in communication services detracted the most.

The most significant contributors to performance were holdings in the online financial trading firm **IG; Admiral**, the financial services group; and **Mears**, the housing and social care provider.

FTSE250 company **IG** was set up in 1974 but the London-headquartered business now operates in 19 countries across five continents. In October **IG** announced it would cull its workforce by around 10% as part of a cost-cutting drive with the aim of saving £50 million a year. However, the company is highly profitable, with revenues rising above £1 billion for the first time in 2023. It is expected to report net profit margins of 35% for 2023 and has a target growth rate of 10% over the medium term.

Admiral is a well-known brand in UK motor insurance and the #1 by market share, but it also writes business in UK household, travel and pet insurance. It has exposure to the US and European markets and a blossoming UK loans business, which has synergies with the core UK motor business. The shares have performed strongly as the motor insurance pricing cycle started to inflect higher, following a period of elevated claims inflation that impacted margins.

The most significant detractors from performance included **4imprint**, a marketer of promotional merchandise, and mining company **Anglo American**.

Despite delivering upgrades to consensus expectations, **4imprint** shares fell in Q3 after the firm's management flagged macro uncertainty – typically a sell sign for a historically cyclical business such as this. However, while it has continued to lag in performance, we believe the business has developed such a large pricing and service quality gap to its competitors – and has fundamentally shifted its cost structure (more variable digital marketing versus historically fixed cost print) – that its earnings should be less cyclical going forward. We therefore see investor concern as an overreaction.

Anglo American was a repeat offender, underperforming throughout much of 2023, and with its share price falling by more than 15% in December alone. This followed the company issuing a warning that its production outlook would be weaker than expected due to problems at its mines in Peru and Chile. With its share price down nearly 45% over the course of 2023, Anglo American could well become a takeover target and we have now switched our exposure to Rio Tinto.

	Name	Allocation (%)	Contribution to Return (%)	Comment
Top 5 quarterly contributors to return	IG Group	3.1	0.6	Revenues rose above £1 billion
	Admiral Group	3.7	0.5	Strong performance on policy pricing trends
	Mears Group	1.9	0.5	Ongoing re-rating plus good operational momentum
	ConvaTec Group	3.3	0.5	Strong organic sales momentum; bullish feedback
	Watches of Switzerland	1.5	0.4	Ambitious and reassuring long range plan for the business

	Name	Allocation (%)	Contribution to Return (%)	Comment
Bottom 5 quarterly contributors to return	4imprint Group	3.6	-0.5	Management warning of macro uncertainty
	Anglo American	1.9	-0.5	Warning of reduced production outlook
	Rentokil Initial	0.8	-0.5	Soft third quarter update
	BP	2.8	-0.3	Oil price weakness
	Unilever	2.7	-0.2	Poor market share trends

Source: Liontrust, Liontrust Income Fund as at 30 September 2023

- **Outlook:**

It is likely to be another volatile year ahead. A general election seems probable towards the end of the year but certainly by January 2025 at the latest. While inflation has been falling in recent months, geopolitical events including ongoing unrest in the Middle East and targets on international shipping vessels could push inflation back upwards. If inflation rises then interest rates – which had been widely expected to fall in 2024 – could remain constant or even go up as the government looks to restrain inflation.

Yet whether it's the general election, pension reforms, or even footballing success at Euro 2024 – we can but hope – or even some other unforeseen macro event, we believe that when a catalyst does emerge the UK market could have a lot of running room.

In our view UK stocks continue to trade at significant discounts – the ongoing hangover of international investors avoiding the UK since Brexit in 2016 and latterly, with the period of acute political upheaval in the UK leading to uncertainty.

We don't know when this valuation discount will end and the trend reverse, but we do believe that investing in stocks at a discount, many of which are businesses with globally-sourced earnings, shifts the odds of attractive total future returns further in our favour.

From lower starting valuations, two attractive pathways for future returns are possible. We will control what we can by reinvesting dividends to compound the portfolio NAV at attractive rates of return. Meanwhile, of course, the possibility of accelerated returns remains intact should the UK market revert to more fundamentally justified levels at some point in the future.

Key Risks

Past performance does not predict future returns. You may get back less than you originally invested.

We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result;

The creditworthiness of a bond issuer may also affect that bond's value. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may have difficulty in paying their debts. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to pay.

This Fund may have a concentrated portfolio, i.e. hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the Fund's value than if it held a larger number of investments.

The Fund may encounter liquidity constraints from time to time. The spread between the price you buy and sell shares will reflect the less liquid nature of the underlying holdings.

Outside of normal conditions, the Fund may hold higher levels of cash which may be deposited with several credit counterparties (e.g. International banks). A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

The level of income is not guaranteed.

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.

Disclaimer