



Liontrust Special Situations Fund

August 2022 review

Fund managers: Anthony Cross and Julian Fosh

The Liontrust Special Situations Fund returned -4.4%* in August. The FTSE All-Share Index comparator benchmark returned -1.7% and the average return in the IA UK All Companies sector, also a comparator benchmark, was -3.3%.

A further surge saw European gas prices breach the €250/MWh level intra-month, taking them to around ten times their normal levels prior to the spikes seen over the last year.

The Bank of England cited Russia's restriction of gas supplies as the major factor in an escalation in inflationary pressures over the summer months. While its decision to raise rates by 50 basis points to 1.75% was expected, the tone of its accompanying comments was even more downbeat than most had expected. It noted that the UK is projected to enter recession in the fourth quarter, with real household income expected to fall sharply in 2022 and 2023.

Consumer confidence data from GfK confirmed a gloomy macroeconomic backdrop, with the August index score hitting its lowest level (-44) since the dataset began in 1974. Investors' assessment of the UK's economic prospects was reflected in a 3% fall in the trade-weighted value of sterling, taking its year-to-date depreciation to 5.7%.

The deterioration in economic outlook prompted another bout of risk-off investor behaviour, resulting in a -1.7% FTSE All-Share Index return. The weakness was most acute among the mid-cap FTSE 250 index, which returned -5.2% for the month.

Four of the fund's five biggest detractors from August performance sit in the FTSE 250. The exception was large-cap pharmaceutical **GSK** (-19%), whose shares slid on fears over litigation risk around the now-withdrawn Zantac heartburn drug. Zantac is the subject of a number of personal injury lawsuits in the US claiming an increased cancer risk. The prospect of litigation has now been known about for a few years but it has come sharply into focus recently, following the publication of Haleon's prospectus on its demerger from GSK.

The Fund's better monthly performers include **BP** (+12%) and **Shell** (+6.1%), which are in the minority of companies benefitting from rocketing energy prices, and **TP ICAP** (+29%), whose business model often sees an uptick in revenues during volatile market conditions. The interdealer broker cited this effect when announcing that higher trading activity across most asset classes had driven a rise in interim profit before tax to £116m, ahead of consensus forecasts of £109m. Growth in its higher-margin Rates division was key in driving the uplift, and TP ICAP expects to benefit further if activity increases at the long end of the bond yield curve. The company also flagged the possibility of a return of surplus capital to shareholders as a result of recent efforts to optimise its capital structure.

Industrial thread manufacturer **Coats Group** (-19%) announced 19% sales growth to \$801m in constant-currency terms in the first half of 2022, following strong underlying market recovery. The group has been effective in combating inflationary pressures so far, pushing through price rises and making productivity improvements. As a result, adjusted operating profit rose 35% to \$125m, representing a margin improvement of 180bps to 15.6%. Although Coats anticipates a moderation in growth in the second half as customers' stock-replenishment activity dies down, it says 2022 financial performance is on track to exceed its prior expectations.

In our past commentaries and blogs, we've often noted that companies with good barriers to competition can often emerge from tough economic periods in an enhanced market position relative to competitors and with opportunities to execute acquisitive growth. There is evidence of this approach at Coats, which has recently announced two large deals. In July it completed the purchase of Texon for \$237m, and August saw the \$117m acquisition of Rhenoflex. Both are footwear component suppliers that Coats believe will have high synergies and establish its position in the athleisure and sports footwear market.

The latter deal was accompanied by a placing and retail share offer to raise £92m at 63.5p, a small price discount which compounded some share price weakness that followed the interim results release earlier in August.

Globaldata (+21%) has also supplemented its growth through acquisitions; 10% underlying revenue in the six months to 2022 rises to 23% overall growth with the inclusion of last year's acquisitions. The consultancy and data analytics group restated its intention to seek out further complementary businesses, with an upcoming refinancing of bank facilities set to release £180m in capital for acquisitions.

Real estate group **Savills** (-20%) recorded an 11% increase in revenues to £1.0bn in the first half of 2022 as transactional divisions experienced a strong start to the year, although – as previously communicated – wage inflation and higher marketing costs saw underlying profit before tax fall 10% year-on-year to £59m. While its management team commented that its 2022 forecasts haven't changed as a result of a market slowdown which began in Q2, it made clear that there is a significant risk of a reduction in activity as markets adjust to higher debt costs following central banks' interest rates rises.

In the half-year to 26 June, **Domino's Pizza Group** (-16%) recorded like-for-like system sales growth of 2.4% on an adjusted basis, but sales were down 5.6% on a reported basis, mostly due to an increase in the VAT rate. Profitability took an even larger dip, with underlying profit before tax dropping 16% as food cost inflation squeezed margins. However, Domino's commented that it passes this inflation on to franchisees in a lagged manner, so expects profits to be second-half weighted. It has maintained its full-year earnings guidance.

Positive contributors included:

TP ICAP (+29%), Globaldata (+21%), BP (+12%), Shell (+6.1%) and PayPoint (+7.3%).

Negative contributors included:

Savills (-20%), GSK (-19%), Coats Group (-19%), Domino's Pizza Group (-16%) and Renishaw (-15%).

Discrete years' performance (%), to previous quarter-end:**
Past performance does not predict future returns

	Jun-22	Jun-21	Jun-20	Jun-19	Jun-18
Liontrust Special Situations I Inc	-11.0%	24.6%	-7.7%	6.5%	15.3%
FTSE All Share	1.6%	21.5%	-13.0%	0.6%	9.0%
IA UK All Companies	-8.5%	27.7%	-11.0%	-2.2%	9.1%
Quartile	3	2	2	1	1

*Source: Financial Express, as at 31.08.22, total return (net of fees and income reinvested), bid-to-bid, institutional class.

**Source: Financial Express, as at 30.06.22, total return (net of fees and income reinvested), bid-to-bid, primary class.

For a comprehensive list of common financial words and terms, see our glossary at:

<https://www.liontrust.co.uk/glossary>.

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.

A proportion of the portfolio is invested in smaller companies and companies traded on the Alternative Investment Market. These stocks may be less liquid and the price swings greater than those in, for example, larger companies.

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