

# Earnings and impact – the perfect combination

Regnan Global Equity Impact Solutions Fund

August 2022

FOR PROFESSIONAL  
INVESTORS ONLY

The first half of 2022 was a tough one for equity investors. For those looking to provide a positive impact and significant growth through small and mid-cap stocks, it was especially difficult. The market was focused on rising interest rates and inflation which led to an indiscriminate sell-off, worst hit were growth stocks. This hurt the strategy which has a bias to companies in this area and we saw a substantial reduction in the portfolio's valuation, taking the median P/E down to 24.9x<sup>1</sup> at present, for a median expected year-on-year earnings growth of 17%<sup>2</sup>, this compares to just 4.3%<sup>2</sup> for the strategy's reference index. Last year unsustainably low interest rates contributed to stretching multiples in some of the short-term valuations of the portfolio on a one-year P/E ratio basis, the current reading however suggests to us that the unwind in the first half of the year has now gone too far and driven the reverse scenario, as valuations have adjusted too far downwards.

Many of the portfolio's holdings are therefore showing strong year-on-year earnings growth at competitive valuations whilst being exposed to some very compelling long-term structural growth trends, that are delivering a positive impact.

To highlight a few of these areas the portfolio is adding to exposure in life sciences amidst the ongoing roll-out of novel therapies. This is a trend that is unlikely to be deterred by even the worst possible recession. A number of the portfolio's companies are on the cusp of commercialising next-generation biologic therapies, such as cell and gene therapies – which holdings such as Sartorius Stedim Biotech, Abcam, Lonza, Agilent, Qiagen and Autolus enable the discovery and production of.

We are also bullish on electric vehicles (EV's) and the technology around these, the fast-rising adoption rate and the infrastructure build that supports them puts us on the verge of a "tipping point". We believe EV sales expectations are likely to be revised upwards well beyond current expectations, which could benefit enablers like Alfen, Valeo, Umicore and Duerr, all held in the portfolio

We also see rising corporate spending on production technology that can help manufacturers reduce their "material footprint" by shrinking the bill-of-materials, following a quick rise in the cost of their inputs, and we expect the likes of holdings Evoqua, Xylem, PTC, Ansys and ATS Automation to see accelerating demand for their cost-reducing wares.

In most cases these are long-term holdings that we feel have derated too far and that all have one thing in common; the resilience of their earnings relative to the market. We feel the more important driver of *relative performance* in the second half of 2022 will be the "e" in the P/E ratio: earnings. The portfolio companies, as a result of their exposure to these trends and underlying positive impact, have therefore historically demonstrated a relative resilience of earnings in the face of macroeconomic headwinds. If earnings in these businesses continue to grow, we would expect the relative attractiveness of these companies to improve further still from here. Indeed, the evidence so far from the ongoing earnings season supports our view, with 20 out of the 30 portfolio companies reporting so far and every one of them beating expectations – with nine even *increasing* their full year profit guidance.<sup>1</sup>

We do remain cautious in the short-term that whilst the second half of the year has started well, the underlying issues we have seen remain unresolved and that the recent market rally has all the hall marks of a 'dead cat bounce'. However, we are confident in the underlying strength of the portfolio and in those businesses that have the ability to continue to grow earnings consistently over time due to their exposures to trends delivering a positive impact. As a result, we believe our clients' patience will be rewarded, as the impact case – perhaps more than ever – is still the investment case.



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Regnan Global Equity Impact Solutions

<sup>1</sup>Source: JOHCM as at 5 August 2022.

<sup>2</sup>Source: Bloomberg as at 5 August 2022.

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