

FUND COMMENTARY – JUNE 2025

CT UK EQUITY ALPHA INCOME FUND



Jeremy Smith
Fund Manager

Summary

- The FTSE All-Share returned 0.5% in June.
- Gross of fees, the fund outperformed the FTSE All-Share.¹
- Key contributors included FirstGroup, Burberry and BT.
- Detractors included the zero weight in Rolls-Royce, along with the holdings in Pearson and GSK.
- We opened a position in Schroders.

Market Background

UK equities made further (albeit modest) gains in June, with the FTSE All-Share up by 0.5% for the month.

Early in the month, some better-than-expected US economic data, alongside optimism that Washington and Beijing could reach a trade deal, eased fears of a global recession. The FTSE 100 hit record highs in the second week of the month. However, equity markets thereafter wobbled as Israel and Iran traded fire. Oil prices surged sharply on fears that Iran could block the Strait of Hormuz. These moves were short lived: oil prices fell back, and risk assets recovered swiftly following US intervention via a long-range attack on Iran's nuclear capabilities and a subsequent ceasefire agreement between Iran and Israel.

Meanwhile, concerns about the UK's government debt lingered. Prime Minister Keir Starmer had to make concessions to Labour MPs who rebelled against planned cuts to disability support and benefits, halving the fiscal "headroom" available to Chancellor Rachel Reeves. Shortly thereafter, a spending review highlighted the limited fiscal resources available to boost growth in the near term. Indeed, recent economic data releases have indicated a slowdown after a strong start to 2025. For instance, GDP shrank more than expected month on month in April, the first month to include the effect of the government's tax increase on employers. Unemployment rose to a near-four-year high in the three months to April, while wage growth slowed more than anticipated over the same period. More positively, the flash estimate for the composite purchasing managers' index for June showed further improvement in private-sector activity.

Other data showed that annual consumer price inflation in May was higher than expected and above the Bank of England's (BoE) target. At its policy meeting the next day, the BoE left rates on hold as expected, though three of the nine-strong policymaking committee voted for a cut – a more dovish vote split than anticipated.

Within the FTSE All-Share, technology fared best, helped by an ongoing global rebound in the sector amid renewed AI optimism. Industrials and energy also outperformed, with the latter aided by the aforementioned rise in oil prices. On the other side, healthcare and consumer staples were weakest. Both sectors are dominated by companies with significant US exposure, so the pound's strength against the dollar proved a hindrance. Healthcare stocks also continued to be pressured by concerns over President Donald Trump's plans to lower the prices of prescription drugs in the US.

¹ Past performance does not predict future returns. Please refer to the KIID document found on our website for further information on the fund performance.

Performance

Gross of fees, the fund returned 0.6%¹ in June and outperformed the FTSE All-Share.

Key contributors included FirstGroup, Burberry and BT.

FirstGroup reported strong results for its fiscal 2025 and announced a new £50 million share buyback. The results included increases in revenue and earnings for both the bus and train businesses, along with a hike to the full-year dividend. FirstGroup's regional bus business is now making good progress on improving margins. The firm's rail division generates surplus cash, which provides the potential to enhance shareholder returns through a progressive dividend policy, buybacks and bolt-on M&A deals. FirstGroup also boasts the largest electric bus fleet in the UK, which continues to expand. We believe the shift to electric buses could bring about further cost reductions and present additional revenue opportunities for the firm. FirstGroup also has plans to branch into leisure transportation, notably through its contract to operate the London cable car.

Shares in Burberry rose on the back of broker optimism ahead of the firm's quarterly results in July. Signs of progress in its "Burberry Forward" strategy reset, which management recently credited for improved performance in the second half of its financial year, have been supportive. The company also highlighted cost reductions made so far, as well as plans to increase savings to £100 million a year by March 2027. There is still significant uncertainty over Burberry's near-term earnings trajectory owing to the tough backdrop for luxury goods companies. However, brand resonance remains strong. Having reviewed the strategy he inherited, which was elevating the brand to higher price levels but leaving core Burberry customers behind, the firm's CEO is seeking to reinvigorate the appeal and revenue generation of the brand. We feel the current share price is highly attractive, having only been lower during the global financial crisis in 2008.

BT was helped by news of a possible takeover bid for TalkTalk, although plans are reportedly only at an exploratory stage. In addition, BT's CEO, Allison Kirkby, discussed the possibility of using AI to increase planned job cuts during the month, along with the possibility of selling the Openreach business, which maintains network infrastructure. Broker positivity about the European telecoms sector was also supportive. BT's CEO has impressed since joining in February 2024, setting out a path to more than double free cash flow over the next five years and dispose of non-core assets.

On the other side, the lack of exposure to Rolls-Royce was unhelpful for relative returns. The shares were boosted by expectations of higher demand for the firm's aerospace and defence products as NATO members committed to increase military spending. Additionally, the UK government announced in June that Rolls-Royce will be part of a consortium to manufacture small modular nuclear reactors.

Other detractors included the holdings in Pearson and GSK.

Shares in educational publisher Pearson fell after sector peer IDP Education issued guidance that suggested operating earnings could almost halve year on year in its fiscal 2025, with changes to visa rules in several countries hitting demand for English language-learning services. Nevertheless, our investment thesis remains intact. Pearson plans to use AI to create improved, more personalised learning experiences for its customers. While Pearson has had to deal with a painful print-to-digital transition within its US higher education textbook division, management has introduced a digital learning platform called Pearson+, which is aimed at winning back the secondary market for US courseware. The company is also expanding its presence in workforce skills and English-language learning. Core competitive advantages include the firm's strong intellectual property and brand name, as well as potential network effects and switching costs via Pearson's subscription model.

GSK underperformed, alongside sector peers, amid renewed pressure from President Trump's aforementioned plans to lower the prices of prescription drugs in the US. However, the pharmaceutical company also reported regulatory progress for expanding the application for the Arexvy vaccine to adults aged 18 to 49 who are at increased risk of respiratory syncytial virus disease in the European Union and Japan. GSK is a leading producer of vaccines and speciality medicines, with a strong international presence and an extensive network of vaccine-manufacturing sites. We favour the firm for its superior dividend yield, high free-cash-flow levels and robust growth prospects. Since the demerger of Haleon, its consumer healthcare business, in 2022, GSK has reduced its debt levels and developed its extensive vaccine and medicine pipeline.

Activity

We sold out of Direct Line ahead of its takeover by Aviva and used the proceeds to open a position in global asset manager Schroders. The company is a high-quality franchise trading at an attractive valuation. Despite near-term challenges due to market uncertainty, we feel the business has potential to grow earnings once the wider environment stabilises, driven at first by cost reductions and thereafter by a more balanced combination

of revenue growth and margin improvement. We also feel there is room for upside from a re-rating of the stock versus its peers as well as for its peer group as a whole.

We also added to our existing positions in LondonMetric Property, Hays and WPP.

LondonMetric is able to offer reliable, repetitive growth in net operating income through a combination of long-term triple net leases and contractual rent increases. The real estate investment trust has long been focused on driving cash flow and targeting compounding income. Following its merger with LXI, the company has greater scale and diversification and offers an attractive yield.

WPP is a high-quality media company that is diversified by geography and client type. The shares are trading at a compelling valuation. Within a complex and fragmented advertising platform space, the company boasts world-class brands with leading market positions and strong client relationships. Moreover, a decade of investment has helped WPP cement its competitive position, while the use of AI technology offers potential for the firm to improve productivity and increase personalisation of advertising at scale. WPP is a compelling self-help story as well, as its versatile business model and simplified structure have enabled the company to achieve a high (and improving) return on capital employed. We also feel that the company has the potential to grow its revenue and improve its operating margin. Additionally, WPP stands to benefit from the disposal of its remaining stake in Kantar, which is not reflected in already very appealing valuation multiples.

Shares of recruitment firm Hays are attractively valued.

Outlook

The US exceptionalism trade has been challenged this year, while the UK market has outperformed. There are also signs that the long-term structural sales of UK equities by major asset allocators are now ending.

Moreover, the UK is becoming a more attractive place to invest, despite recent concerns about the elevated fiscal deficit. Speculation is already rife around whether the government may be forced to break its pledge not to raise taxes during the current parliament in this year's autumn budget. Nevertheless, the UK still boasts a relatively stable government. We also expect interest-rate cuts to continue, with the BoE having more room to ease than the Federal Reserve. Along with still-intact Covid-era "piggy banks", rising house prices and the potential to draw on home equity, this should encourage consumers to spend rather than save. The key ingredients are therefore present for a UK consumer boom, especially if confidence rises.

While there are concerns about the impact of US tariffs on trade under the Trump administration, the UK has so far avoided the worst potential outcomes. We believe this is due in part to the UK market's heavier exposure to defensive sectors, in which the fund is overweight, and low trade surplus with the US. In addition, while the details are still unclear, the limited UK-US trade deal reached in early May included concessions on some of the higher levies previously announced, including for steel and automobiles.

At the same time, the fund has limited exposure to the top five index constituents (HSBC, Shell, AstraZeneca, Unilever and Rolls-Royce), where most of the gains in the FTSE All-Share have been concentrated this year. We suspect that hedge fund and index repositioning has to some degree been at work behind the gains from these mega-caps given the diverse nature of their business activities.

Meanwhile, with 75% of the UK market's revenues coming from overseas, UK businesses are generally resilient to any potential domestic economic headwinds. The UK equity market as a whole is still attractively valued relative to its own history and to international peers, despite its outperformance this year. We therefore expect UK companies to remain attractive targets for overseas takeover and private-equity bids.

Our focus remains on long-term ownership and quality stewardship. As patient conviction investors, we will continue to avoid whipsaw momentum trades and concentrate on company fundamentals to target strong risk-adjusted returns.

Key Risks

The value of investments can fall as well as rise and investors might not get back the sum originally invested.

Where investments are in assets that are denominated in multiple currencies, or currencies other than your own, changes in exchange rates may affect the value of the investments.

The fund has a concentrated portfolio (holds a limited number of investments and/or has a restricted investment universe) and if one or more of these investments declines or is otherwise affected, it may have a pronounced effect on the fund's value.

The fund may invest in derivatives (complex instruments linked to the rise and fall of the value of other assets) with the aim of reducing risk or minimising the cost of transactions. Such derivative transactions may benefit or negatively affect the performance of the fund. The Manager does not intend that such use of derivatives will affect the overall risk profile of the fund.

The fund typically carries a risk of high volatility due to its portfolio composition or the portfolio management techniques used. This means that the fund's value is likely to fall and rise more frequently and this could be more pronounced than with other funds.

The risks currently identified as applying to the fund are set out in the "Risk Factors" section of the prospectus.

IMPORTANT INFORMATION. FOR PROFESSIONAL INVESTORS ONLY (not to be used with or passed on to any third party). Your capital is at risk. Columbia Threadneedle Specialist Funds (UK) ICVC ("CTSF") is an open-ended investment company structured as an umbrella company, incorporated in England and Wales, authorised and regulated in the UK by the Financial Conduct Authority (FCA) as a UK UCITS scheme. This material should not be considered as an offer, solicitation, advice or an investment recommendation. This communication is valid at the date of publication and may be subject to change without notice. Information from external sources is considered reliable but there is no guarantee as to its accuracy or completeness. The CTSF's current Prospectus, the Key Investor Information Document (KIID), latest annual or interim reports and the applicable terms & conditions, are available from Columbia Threadneedle Investments at PO Box 10033, Chelmsford, Essex CM99 2AL, your financial advisor and/or on our website www.columbiathreadneedle.com.

In the UK and in Switzerland: Issued by Threadneedle Investment Services Limited. Registered in England and Wales, Registered No. 3701768, Cannon Place, 78 Cannon Street, London EC4N 6AG, United Kingdom. Authorised and regulated in the UK by the Financial Conduct Authority.

For Distributors: This document is intended to provide distributors' with information about Group products and services and is not for further distribution. For Institutional Clients: The information in this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge and who meet the regulatory criteria to be classified as a Professional Client or Market Counterparties and no other Person should act upon it.

Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies.