FUND COMMENTARY – Q2 2025
CT UK FUND

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Summary

- UK equity markets rose over the quarter.
- Gross of fees, the fund underperformed the FTSE All-Share.
- Key detractors included the lack of exposure to Rolls-Royce and BAE Systems, along with the holding in Pearson.
- Contributors included Johnson Matthey, Burberry and the zero weight in Diageo.
- We made no significant changes to the fund over the quarter.

Market Background

UK equities posted further gains over the second quarter (Q2), with the FTSE All-Share returning 4.4%.

The period started with a sharp sell-off in global equity markets following US President Trump's "Liberation Day" announcement of sweeping "reciprocal" tariffs, which were much larger than expected in size and scope and stoked fears of higher inflation and lower growth. Given its heavier exposure to defensive sectors, the UK stock market held up better than its US and European counterparts in the sell-off.

Global markets soon rebounded as Trump called a 90-day pause on many of the highest tariffs. Hopes grew that the US could reach trade deals with key partners, with the UK becoming the first country to do so. The UK also signed deals with the EU and India in May, though these had little market impact. However, equities were boosted by optimism that the US and China would reach an agreement on trade.

The FTSE All-Share lagged the global rally, which was led by high-growth names. A stronger pound and lower oil prices also proved unhelpful given the market's sizeable exposure to "dollar earners" and energy stocks. Oil prices declined amid concerns over subdued demand and as the OPEC+ group announced plans to ramp up output. That said, prices spiked briefly in June following a brief spat between Iran and Israel, before later stabilising after the two countries agreed to a US-brokered ceasefire.

Q2 was also marked by concern over rising government debts and deficits in the developed world. 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.

Meanwhile, economic data pointed to a slowdown in the UK after a strong start to 2025. Consumer price inflation remained above the Bank of England's (BoE's) 2% target, rising more than expected in April and May. The BoE reduced interest rates by 25 basis points (bps) in May and then held rates at its meeting in June, though three of the nine rate setters voted for a cut. This was a more dovish outcome than anticipated and stoked expectations of further easing.

By sector, technology fared best in the FTSE All-Share, aided by a global rebound in the sector amid renewed optimism around AI and demand for semiconductors. Industrials also outperformed, as did the interest-rate-sensitive utilities and real estate sectors, which were boosted by hopes of further rate cuts. On the other side, energy was weakest owing to lower oil prices. In addition, healthcare underperformed amid concerns over tariffs and Trump's plans to lower the prices of prescription drugs in the US.

Performance

Gross of fees, the fund returned 1.8% for the quarter and trailed the FTSE All-Share.[1]

The relative underperformance was driven by unfavourable stock selection, particularly in industrials, although choices in financials and consumer staples also detracted. However, picks in real estate were modestly beneficial. Sector allocation made a positive contribution in aggregate thanks to the overweight in industrials, which more than offset detraction from the underweight in financials.

At the stock level, detractors included the lack of exposure to Rolls-Royce and BAE Systems. Both stocks rose amid optimism about European countries enhancing military capabilities, especially as a NATO summit during the quarter resulted in most members committing to higher defence spending. Additionally, the UK government announced that Rolls-Royce will be part of a consortium to manufacture small modular nuclear reactors.

The holding in educational publisher Pearson also detracted. Q1 results were in line with expectations, with sales edging up, and management reaffirmed its full-year guidance. However, the shares fell amid signs of slowing sales in the Virtual Learning and English Language Learning segments. Concerns about demand for English language learning services were exacerbated after sector peer IDP Education pointed to changes to visa rules in several countries as a potential headwind. The pound strengthening against the dollar – Pearson has significant US earnings – may have weighed on the stock as well. Our investment thesis remains intact. Pearson plans to use AI to create improved, more personalised learning experiences for its customers. While the firm 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.

More positively, Johnson Matthey and Burberry were among the top contributors in Q2.

Shares in Johnson Matthey surged after the speciality chemicals company announced a £1.8 billion deal to sell its catalyst technologies business to US industrials group Honeywell, with £1.4 billion of the proceeds to be returned to shareholders. The firm's fiscal full-year results were in line with expectations, with earnings per share up year on year, although sales declined. Following years of research and development into sustainable technologies, Johnson Matthey should benefit from its continued investment in hydrogen technologies, circularity and decarbonisation. In our view, the company is well placed to benefit from many emerging global themes such as electrification and the use of alternative forms of energy.

While Burberry reported lower full-year revenues and operating profits, the shares outperformed on signs of progress in its "Burberry Forward" strategy reset, which management credited for improved performance in the second half of the firm's financial year. The company also highlighted cost reductions. 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.

The zero weight in Diageo also supported relative returns. The stock continued to be pressured by concerns about weak demand. In addition, while the firm's fiscal Q3 results in May were generally strong, the shares fell after management reported a potential $150 million hit to profits from US tariffs.

Activity

We made no significant changes to the fund over the quarter.

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 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.

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.

Overall, we will continue to focus on company fundamentals and use volatile markets to top up and buy favoured stocks to deliver solid 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.

The fund may exhibit significant price volatility.

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 investment policy of the fund allows it to invest in derivatives for the purposes of reducing risk or minimising the cost of transactions.

All the risks currently identified as being applicable to the fund are set out in the “Risk Factors” section of the Prospectus. Please read the Key Investor Information Document and the Fund Prospectus if considering investing.