FUND COMMENTARY – Q1 2025
CT UK SUSTAINABLE EQUITY FUND

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Summary

- UK equities posted gains over the first quarter (Q1).
- Gross of fees, the fund underperformed its benchmark, the FTSE All-Share.[1]
- Relative performance was impacted by the zero weights in aerospace and defence names, as well as in the oil and gas sector, which the fund cannot own.
- The fund's small- and mid-cap exposure was also unhelpful in a weak quarter for these stocks.
- We believe that the transition towards renewable energy remains intact.

Background and Developments

The FTSE All-Share returned 4.5% over the quarter and outperformed global averages. The gains were concentrated in mega-cap stocks; the top five index constituents contributed roughly half of the benchmark's return. However, small- and mid-cap equities underperformed, posting negative returns, amid concerns about the stalling UK economy and a global rotation from high-growth names.

Over the period, a flurry of tariff announcements from US President Trump stoked concerns about the hit to global growth and a potential rise in inflation. The UK initially appeared to avoid being directly impacted by these measures, but Trump later threatened levies on virtually all US trading partners, including the UK. The resulting risk-off environment benefited the FTSE All-Share, given its significant defensive exposure, but weighed on shares of smaller companies.

At the same time, the new US administration's plans to reduce military support for its allies spurred pledges for greater defence spending by the UK government and its European counterparts. This heightened concerns about the UK's already large fiscal deficit and high government borrowing and pushed up gilt yields, which proved a further headwind for small- and mid-caps, as did a rotation from growth. This last factor was triggered by sharp declines in major technology stocks following the launch of DeepSeek – a new low-cost and seemingly more efficient Chinese AI model.

UK economic data releases over the quarter initially pointed to a continued softening in growth. However, as the period progressed, forward-looking indicators painted a more encouraging picture. For instance, the composite purchasing managers' index remained in expansionary territory over Q1, and in March, moreover, the reading for a key consumer confidence index indicated an improvement in sentiment. After reducing interest rates by 25 basis points in February, the Bank of England (BoE) held fire in March, with the governor stating that policymakers need more data to assess the trade-off between the slowing UK economy and the persistence of wage and price pressures.

In terms of sustainability developments, Trump issued executive orders on climate policy withdrawing the US from the Paris Agreement, suspending disbursements under the Inflation Reduction Act and promoting fossil fuels at the expense of clean energy and electric vehicles. Attacks on diversity programmes by the new administration also threaten a wave of legal actions for firms.

Against this backdrop, many high-profile financial firms have retreated from diversity and ESG initiatives, such as the Climate Action 100+ (CA100+) scheme. In February, however, a coalition of 26 financial companies with combined funds

[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.

of $1.5 trillion released the Asset Owner Statement on Climate Stewardship, calling on asset managers "to develop and evidence a robust stewardship strategy that addresses the urgency of action needed on climate-related risks". Meanwhile, the EU Commission published its proposals for corporate sustainability reporting, seeking to lessen the burden of reporting on companies by reducing data requirements, improving consistency and limiting the scope of the rules.

Performance

Gross of fees, the fund underperformed the FTSE All-Share over the quarter.[1]

Relative performance was particularly impacted by our zero weight in aerospace and defence, chiefly Rolls-Royce and BAE Systems. Both stocks rallied as the UK and EU committed to higher military spending. Both companies also reported strong full-year results for 2024. We do not own these stocks as the companies generate significant revenues from the manufacture of weapons.

Likewise, not holding Shell – due to the issues that the company faces from a sustainability perspective – also detracted. The shares were boosted by bouts of strength in oil prices and as the company hiked the dividend and announced an expanded share buyback programme.

The fund's small- and mid-cap exposure, particularly in less liquid names, also proved unhelpful. Examples here included Ceres Power, which is listed on the Alternative Investment Market (AIM). The firm is a leading developer of clean energy technology. Shares sold off in February after Robert Bosch GmbH announced plans to sell its 17.4% stake in the company for strategic reasons. The holding is part of our *renewable energy* theme. Ceres is a leading developer of clean energy technology, partnering with global industrial companies to install and integrate power cells that produce zero carbon dioxide, sulphur dioxide or nitrogen oxide emissions when used with pure hydrogen.

On the other side, the absence of Diageo and Glencore added value. Both stocks underperformed due to disappointing results and tariff-related uncertainty. Glencore's full-year results for 2024 showed a drop in earnings and $2.3 billion in impairment losses in part due to weak coal prices. We do not own the stock due to the issues the firm faces from a sustainability perspective. Meanwhile, Diageo reported a fall in profit and net sales in its interim results. Management also suspended its medium-term guidance, citing uncertainty about the impact of US tariffs and weak demand.

The fund benefited from its holding in Standard Chartered. The bank reported a year-on-year rise in profit, driven by strength in the wealth management business. In addition, it beat its own target for net interest income and announced a $1.5 billion share buyback. Standard Chartered has a robust capital position and a strong management team with a focus on cost controls and growing capital returns. The firm is making headway towards its multi-year targets for green financing – an area with high potential revenue growth. With deep exposure to emerging markets, Standard Chartered plays a critical role in financing inclusive growth, climate resilience, and SME development across Asia and Africa. This is where ESG capital is most impactful.

Activity

We initiated positions in HSBC, Marks & Spencer and CRH.

HSBC offers attractive exposure to increasing wealth in Asia, specifically in China, where the bank has a strong position. The lender also has a self-help story and recently embarked on a significant cost-cutting and restructuring programme. Along with reinvestment, this should help lift the return on tangible equity. The company has an AA rating from MSCI. We engaged with HSBC's board through the investor forum on a range of topics, including the firm's recent climate plan. HSBC's focus on engagement includes three areas: net zero (environmental), inclusion and resilience (social) and acting responsibly (governance).

We took advantage of share-price weakness to start a holding in Marks & Spencer (M&S). As free cashflows have turned positive, the firm has managed to reduce debt. We are encouraged by how management is reshaping and modernising the company, and we feel the digital business, where M&S currently lags its peers somewhat, has potential for expansion. The shares had an amazing run over 2024, but we feel that the retailer still has lots of potential for improvement in its supply chain and store footprint. Market share gains should also lead to improved margins in food and clothing, while the strong balance sheet creates room for higher dividends. The stock valuation is back at the ten-year average, even though faster top-line growth should boost earnings. From an ESG perspective, the company has an AA rating from MSCI, reflecting proactive environmental initiatives and a robust governance framework. The company also leads peers in terms of ethical raw-material sourcing in its supply chains.

CRH is a high-quality building materials business with a number of competitive advantages, including a robust balance sheet, attractive growth potential and strong pricing power. Demand for infrastructure in the US and abroad is expected to remain strong, underpinned by state, government and EU funding. The outlook for residential and non-residential demand is resilient too. The company has strong ESG credentials as it is an industry leader in the transition to renewable energy for transportation and sustainable building materials.

We exited Equals Group ahead of the firm's takeover by a private-equity consortium.

Outlook

In recent months, there have been concerns about the UK's slowing economic growth and increased Government spending and borrowing. However, household disposable income has been rising, while savings remain high, with Covid-era "piggy banks" still intact. We still expect the BoE to continue with interest-rate cuts, which, along with a stable economy, should encourage consumers to spend rather than save. The UK consumer is potentially in a reasonable position, albeit lacking in confidence.

Moreover, with the largest majority government in 25 years, Labour should at least deliver the political stability investors have long craved – at a time when the political backdrop in Europe and the US appears murky. In addition, while there are concerns about the impact of US tariffs on trade under the Trump administration, the UK seems to have 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.

Furthermore, with 75% of the UK market's revenues coming from overseas, UK businesses are generally resilient to any potential domestic economic headwinds, although certain companies with significant US exposure are vulnerable to the "reciprocal" tariffs announced by Trump in early April.

Nevertheless, the UK market boasts many global structural leaders that are markedly discounted compared to their peers in other developed countries; indeed, the UK equity market as a whole is attractively valued relative to its own history and to international peers. The UK small-cap market offers even more significant value. Increasing inflows, combined with falling interest rates amid a gently slowing UK economy with improving corporate profits, should provide a strong backdrop for what is still a very unloved asset class. We also expect UK businesses across the market-cap spectrum to remain attractive targets for overseas takeover and private-equity bids.

Meanwhile, we retain our view in the transition towards renewable energy over the medium-to-long term, given global net-zero goals and associated regulation.

We believe future winners will be businesses that are inherently sustainable and generate sustainable solutions for some of the biggest problems the world faces, while also managing internal, non-financial (ESG) risks well.

Our engagement activities cover strategy, corporate governance and the management of material environmental and social risks. For portfolio companies and firms we are considering for investment, our engagement focuses on quantifying the impact of business operations in terms of revenue alignment to the UN SDGs, along with each company's sustainable outcome.

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 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 aims to invest in companies which deliver sustainable outcomes and in doing so adheres to a set of Sustainable Investment Guidelines. The Guidelines will affect the fund's exposure to certain sectors, which may impact the performance of the fund positively or negatively relative to a benchmark or other funds without such restrictions.

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.