2022 Review & Outlook

OCEAN EQUITY

Market Commentary

February 2023

2022 Review

Following on from our review of the first half of 2022, in this report, we will review the 2nd half of 2022 and reflect on the year ahead. The second half of 2022 saw a continuation of the conditions we saw in the first half. Further weakness in the global economy, troubling and deepening political situations with the Russian invasion of Ukraine, China & Taiwan and a general sense of unease between the UK and EU principally in relation to the Northern Ireland protocol. Inflation continued to spike higher with food, energy and labour costs leading to added pressure on consumers facing a cost-of-living crisis. Central banks responded aggressively with a succession of interest rate rises whilst maintaining a hawkish position backed up by a doctrine of "we'll do whatever it takes" to reign in rampant inflation. This resulted in the BoE increasing interest rates nine times in 2022 as it tried to reduce inflation and bring it back to its mandated 2% level. Another concern for investors was the political instability in the UK coupled with the disastrous Truss/Kwarteng administration and accompanying mini-budget which resulted in a bout of market instability and Truss resigning after 44 days in office. The arrival of Rishi Sunak as Prime Minister and Jeremy Hunt as Chancellor in October has led to a more prudent, coordinated and sensible economic approach. Calm has been restored to markets and investor attention now looks towards the general election likely to be held in 2024.

Performance

Fund performance was frustratingly poor in the second half of 2022 as the fund continued to be impacted by a compression of high growth stocks. This was compounded by the fact that we do not typically invest in UK high street banks, oil and gas and miners as demand tends to be more cyclical, their fixed assets and costs are higher, and profitability and cash generation tends to be lower on average over the longer-term.

Portfolio Activity

We disposed of several investments towards the end of the period under review and used the funds to invest into businesses that will increase the portfolio's quality and diversification and which importantly have better long-term prospects. We divested from **RWS Holdings** as we think that their competitive advantage has been eroded over the last year. There has also been significant management changes over the last 18 months. We also sold **Strix** following a profit warning over weak trading during their key Christmas period due to Chinese government enforced lockdowns and also due to concerns over the growing debt profile following an acquisition. We do not think the above are bad businesses but we believe we have found better businesses with strong and growing competitive positions.

We initiated a position in **John Deere (JD)** – global leader in the manufacture and distribution of agricultural, construction and forestry equipment. We think JD with its deep-rooted culture of R&D and manufacturing excellence has the ability to be at the forefront of the rapidly evolving agricultural technological revolution. Its high-quality equipment – that must be serviced and maintained - has embedded the intelligent use of GPS, data and analytics which allows farmers to provide food (wheat), fabric (cotton) and fuel (maize and sugar cane) more quickly, efficiently, and precisely and thereby becomes cheaper for consumers. The increasing use of software for better agricultural outcomes gives JD a strong and growing competitive position whilst it is attractively valued against medium term prospects for revenue and cash generation.

We also initiated a position in **Telecom Plus (TEP)** - a multi service utility supplier of energy, broadband, mobile and insurance via its trading name Utility Warehouse to the UK consumer via a network of self-employed distributors. The energy market has gone through an extended period of disruption in which TEP has been very patient and did not get drawn into uneconomic short-term market behaviour that saw supplier numbers fall from c.40 to c.13. During this time TEP has been strategically investing in its platform in order to accommodate strong customer growth whilst maintaining a high level of customer service. TEP is the most competitively priced energy supplier in the UK and it has a unique business model whereby selling agents are able to supplement their incomes in the cost of living crisis. TEP must keep innovating and be laser-focused otherwise agents won't be willing to sell to family and friends. We have long admired their ability to be patient, look after customers and grow their compelling multi-service proposition. The business is well positioned to grow to over 1 million customers from current levels of c. 814,000 whilst offering UK consumers the most competitive energy prices available. In addition, it generates high returns on invested capital (ROIC) and robust FCF generation and requires little capital to grow. The valuation is attractive when you consider the potential growth in revenue and cash over the next few years.

Outlook

The outlook for 2023 is bound by a range of scenarios but the general view among investors is that interest rates will continue to increase, and the global economy will slow over coming months. 2022 was a sobering year as shares in many of our high-quality businesses fell despite operating very well in terms of revenue, cash and market share. However, as custodians of your capital we think it is critical to learn from our experiences and 2022 has been a positive learning curve.

We will continue to move forward cautiously but we are confident in our ability to allocate your capital as efficiently as possible using the same 'high-quality' company focus combined with a long-term strategy, whatever the wider environment throws at us. It is critical to remember that many of our businesses have strong structural tailwinds with themes running

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through the portfolio such as the move to net zero via renewable energy and the electrification of industrial processes. Similarly, the provision of mission critical products and services often funded via opex budgets which are less likely to be squeezed in a weaker economic climate. The digitisation of commerce and with it increased levels of automation, e-commerce and cloud computing. The provision of data and decision making tools to deliver better decision making for businesses and consumers. Everyday repeat purchase items via food, personal care, health and hygiene. We also have healthy exposure to aspirational brands and premiumisation of consumer products. We continue to think our businesses are well positioned with experienced management teams that will successfully navigate 2023 and become substantially more valuable over the medium to long-term.

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