McInroy & Wood

PERSONAL INVESTMENT MANAGERS

Focusing on fundamentals

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Equity market returns have been narrowly concentrated in recent years. But the unpredictability of market timing highlights the need for a disciplined investment approach and a diversified portfolio of global companies. In this article, Guido Bicocchi explains why focussing on the fundamentals has always been a key part of our investment philosophy.

Question: How have investment portfolios fared recently?

For the year to 31st August, the total return for the Balanced Fund is 7% and for Income Fund is 10%, both of which compare favourably to UK inflation of 4% over the same period.

However, we are mindful that recent returns have not kept pace with some of your expectations. Especially when compared to the US technology stocks, which have largely driven market performance.

Over shorter periods, financial market returns can be heavily influenced by investors' sentiment, as the recent reaction to US unemployment figures highlighted. But in such an environment, it is critical that we don't deviate from our disciplined investment approach.

The unpredictability of market timing underscores the need for consistent exposure to a global list of companies.

Diversification has long been recognised as an effective strategy for reducing risk while potentially boosting returns. A principle that has always been a central factor in our investment approach.

Question: Why do you think your investment approach will be successful in the future?

Not all risks can be predicted. So, we focus on investing in companies that are resilient enough to adapt to unforeseen challenges. Indeed, the strongest companies not only survive in adverse conditions but often find ways to capitalise on them.

As long-term investors, it can be frustrating when the share prices of businesses with strong prospects suffer based on short-term noise. However, history suggests that fundamentals will reassert their influence over time.

It will be those companies with sound financial health, market leadership, and flexibility that emerge successful.

Investors' attention will, with time, return to these fundamentals that drive long-term performance. When it does, we believe that our disciplined investment approach should provide a good platform for returns.

Question: What investment themes are you particularly excited about?

It's an exciting time to be picking stocks!

Our investment selection focuses on stocks that are well placed to take advantage of important trends such as the use of IT and energy transition.

We are all increasingly reliant on digital technologies such as the internet, mobile devices and cloud computing.

We are concerned that the growth that has been enthusiastically projected in artificial intelligence may not come through as quickly as financial markets expect.

However, there are many market-leading companies that stand to benefit from global digitalisation over the long term.

Tokyo Ohka Kogyo (or TOK) was added to portfolios within the last year. It is a Japanese manufacturer of photoresists, a light-sensitive coating essential in the production of microchips. It is the world leader in this area and supplies to all major chip manufacturers. The continuing miniaturisation of microchips, associated with smaller and more powerful devices is expected to drive demand for TOK's photoresists.

Currency movements have affected the sterling value of the Japanese investments held in portfolios. However, our recent research trip to the country suggests prospects remain robust. As such, even if the TOK experiences fluctuations in orders over the course of a business cycle, it looks well positioned to see considerable long-term sales growth.

Question: How are you investing in the energy transition?

The shift in how energy is supplied and consumed is another interesting investment theme. This is a change that will run over many decades. However, its growing importance can be seen in governments' economic policies worldwide, and its effects are already recognisable in the results of some of our holdings in this area.

National Grid and Schneider Electric have been held in portfolios for several years. Many of you will be familiar with National Grid as the owner of transmission networks in the UK and parts of the USA. It is responsible for building and maintaining the major infrastructure needed to connect new greener energy sources to businesses and homes.

Perhaps less well known, but equally important, is Schneider Electric, a leading manufacturer of electrical power products, which help improve energy efficiency. While its products may be less obvious than National Grid's, they are critical to factories, microgrids and electric vehicle chargers.

Both businesses will play vital roles in expanding and improving electricity provision.

Question: What factors will likely affect your investment strategy over the next year?

Interest rates. A trend towards reducing interest rates appears to be gaining momentum. Lower savings rates and borrowing costs should encourage consumer spending and capital investment, in turn boosting growth prospects. But central banks must balance supporting economies with the dangers of rekindling inflation, and recent market fluctuations highlight the fragility of investor sentiment.

Political change is another area I expect will feature in our discussions. Investors are assessing the fiscal implications of Labour's general election victory in the UK. Albeit the perception of a stable government should increase the relative attractiveness of the UK as a place to invest. Meanwhile, the US presidential election is finely balanced. A Republican President has traditionally been seen as more encouraging for corporate prospects. However, Donald Trump's economic approach, favouring tariffs and populism, poses risks to inflation and global trade.

Investor sentiment remains vulnerable to shifts in interest rates and geopolitics. However, there are still reasonably valued companies that are well placed to deliver positive and sustainable investment returns.

Question: How would you summarise McInroy & Wood's current investment thinking?

Our investment strategy continues to focus on the fundamentals of strongly financed and cash-generative companies, in sectors well-placed for long-term growth. At the same time, the bond allocations in balanced portfolios offer diversification and benefit from attractive yields.

This measured approach should mean portfolios are less subject to swings in investor sentiment, while proving rewarding for clients over the long term.

I hope you've found the topics discussed interesting and informative.

If you have any questions regarding this article, your investments in general or any suggestions of themes you would like us to cover in future content, please do get in touch.

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The views expressed in this article are as at the time of writing. They are not intended as a recommendation, promotion or advice on any particular sector or stock.

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