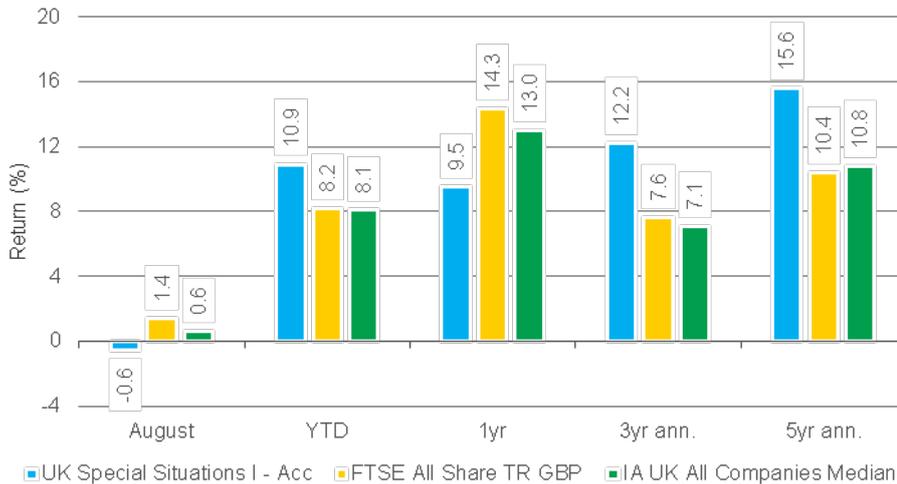


# Legal & General UK Special Situations

## Fund Update – August 2017

### Performance



Source: Lipper, net returns 31/08/2017. Past performance is not a guide to future performance.

### FUND COMMENTARY

Following a solid July, the FTSE All Share continued to rise in August, closing the month up 1.4%. This represented a solid performance in the face of a spike in market volatility driven by the rise of global geopolitical issues. In the UK, Brexit talks reached a stalemate over financial settlement, with both parties unable to agree on several topics. The corporate reporting season has also begun to wind down, although headlines were captured by profit warnings from Provident Financial, Dixons Carphone and WPP, prompting a large sell-off in these companies.

On a size basis, large caps were at the top of the table, while small caps delivered a negative return. By sector, miners yet again outperformed as metal prices rallied on US dollar weakness. Consumer staples, led by beverage and tobacco companies also enjoyed a strong month. Meanwhile, media, general retailers, telecoms and banks all underperformed the wider market. At a style level, earnings momentum sat on top of the leaderboard, while value stocks and domestic-exposed companies were out-of favour in the period.

From a macro perspective, UK growth is slowing, with the leading indicators of consumer sentiment and hard economic data showing a deterioration this month. Real wage growth is still falling, while monthly retail sales at least improved, helped by the contribution from food (non-food sales were negative). Overall, despite the macro uncertainty, UK plc looks in good shape, with the corporate profits recovery in line with international and domestic PMIs. Supportive trading updates underpin what are not excessive UK valuation levels in absolute terms.

The fund delivered a return of -0.6% in August, disappointingly underperforming its benchmark by 200bps. This was predominantly driven by stock selection in financials, industrials and basic materials. Our underweight in consumer goods also proved unhelpful.

### ATTRIBUTION DRIVERS

At a stock level, Dixons Carphone was the largest negative contributor, following a profit warning from management. The company meaningfully guided down earnings for the full year based on continued lengthening of the handset cycle (lower mobile churn), particularly in postpay. They have also been affected financially by EU changes in roaming legislation, while the switch of Honeybee from upfront to software-as-a-service (SaaS) has also been a drag.

Global Ports detracted from returns, following disappointing first half year results. The main issue was the Turkish cruise ports, where passenger numbers were substantially lower than anticipated. We think this reflects a reluctance from the cruise lines to call at Turkish ports, given the on-going geopolitical situation in the country. There was however better news from the commercial ports, but not enough to offset the pressure from cruise activities. Improved tourist demand in the second half will be key for achieving full year guidance.

Elsewhere, during a month of low trading volumes, our holdings in IP Group, Xaar and Shire also detracted from returns in the period.

Source: LGIM. 31/08/2017. All attribution is based on gross performance.

### KEY FUND CHARACTERISTICS

#### Investment objective

The objective of this fund is to provide growth. The fund manager will typically invest between 80% and 100% in UK companies, although we may also invest in companies from Europe. We will invest in companies considered, in the manager's view, to be undervalued by the market.

#### Fund size

£268m

#### Benchmark

FTSE All Share Index

#### Target

+ 5% p.a. (rolling 3-year periods) vs. benchmark

#### IA sector

UK All Companies

#### Legal structure

UK Unit Trust, UCITS compliant

#### Ongoing charges

0.94% (I class)

#### Dealing cut-off time

12.00 (noon) GMT

#### ISIN

GB00B3DMY345 (I class – Acc)

#### Launched

10 November 2008

#### Active share

86.3%

#### Top 10 holdings

42.7%

#### No of stocks

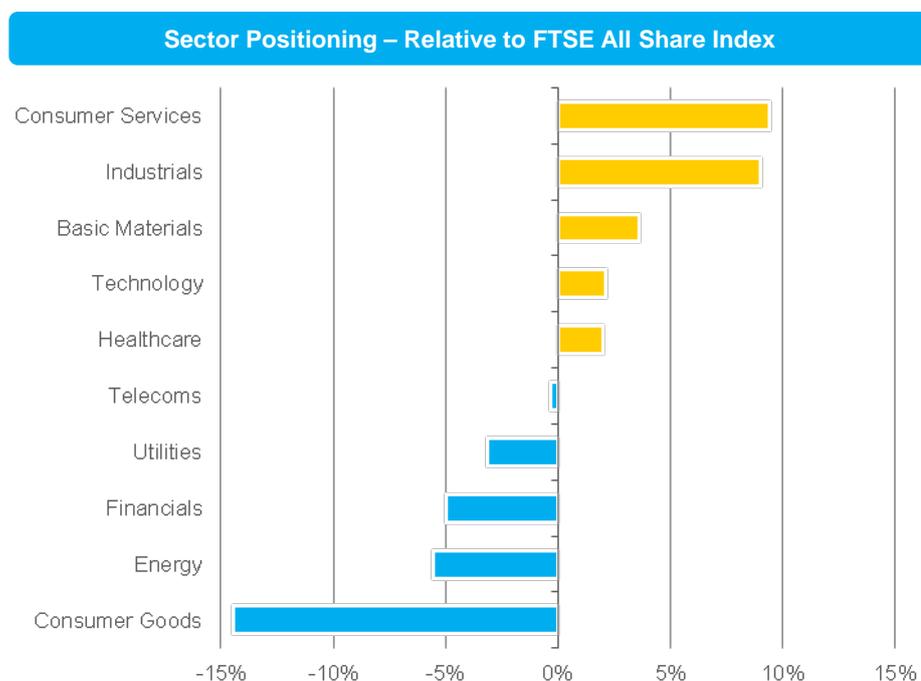
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Source: LGIM. 31/08/2017.

## FUND COMPOSITION

Top 10 Holdings		
Prudential	Financials	4.8%
NMC Health	Healthcare	4.6%
DCC	Industrials	4.4%
Playtech	Consumer Services	4.3%
Bayer	Materials	4.3%
St James's Place	Financials	4.2%
Carnival	Consumer Services	4.2%
CRH	Industrials	4.1%
GVC Holdings	Consumer Services	3.9%
Royal Dutch Shell	Energy	3.9%
	Total	42.7%

Top Active Weights	
NMC Health	+4.5%
Bayer	+4.3%
Playtech	+4.2%
DCC	+4.2%
St James's Place	+4.0%
GlaxoSmithKline	-3.1%
BP	-3.6%
Royal Dutch Shell A	-4.0%
British American Tobacco	-4.6%
HSBC Holdings	-5.3%



Portfolio Characteristics	
Top 10 positions	42.7%
Top 25 positions	83.8%
Active share	86.3%
# of Holdings	34
12m Forward P/E	14.2x
Forecast Earnings Growth	23.4%
Dividend Yield	2.5%
FTSE 100 Index	37.3%
FTSE 250 Index	30.2%
FTSE Small Cap Index	26.4%
Other	6.1%

In terms of leading positive contributors, we saw stand-out performance from NMC Health. The leading UAE private sector healthcare provider reported impressive first half results across the board. Healthcare revenues were particularly strong, driven by the Al Zahra acquisition and NMC Royal bed rollout. Cash generation looks solid and the group are well on track to achieve full year guidance. We believe NMC are well positioned to benefit from secular growth trends for private sector healthcare in the middle-east region, reflecting its acquisitive growth strategy, focus on new treatments in long-term care and balance sheet strength.

Low-cost airline Wizz Air continues to march higher. The Central and Eastern European (CEE) focused operator reported strong July traffic stats, with year-on-year load factor up 1.8ppts to 94.5% and seat capacity of growth up 24%. As GDP grows in the CEE regions, we see consumer propensity to fly accelerating, leading to faster market growth.

## TRADING ACTIVITY

Following continued disappointing performance we took the decision to sell down our position in Dixons Carphone, as we have now lost conviction in the investment case. This predominantly stems from uncertainty over whether the current problems represent a cyclical or structural shift, with the added risk that electricals could also come under pressure. We expect the decision to preserve market share (investment) in the Carphone business will likely erode profitability in the short term.

We also sold our holding in Saga Group. While the business is fundamentally in good shape from an earnings and balance sheet perspective, we find more attractive growth opportunities elsewhere. Some of the cash was re-invested into our holdings of Equiniti Group and Urban & Civic.

# Legal & General UK Special Situations

## Reasons to invest

### DEFINING SPECIAL SITUATIONS

Special situations are undervalued opportunities, mispriced by investors, either in the early stages of recovery or suffering from indifferent performance. We categorise these into the following value and growth subsets;

- Refinancing (balance sheet repair, alignment of shareholder interests)
- M&A opportunities (enhancing growth, supportive market environment)
- Secular growth leadership (barriers to entry, strong product offering)
- Event driven strategy (IPO's, placing's)

### CONCENTRATED INVESTMENT APPROACH

A bottom-up approach to stock selection, leads us to construct concentrated fund of approximately 30-40 companies. We believe that a concentrated fund provides a greater opportunity to outperform the comparative index by giving the stocks we believe will deliver higher returns greater weighing. The fund is also relatively unconstrained, allowing the manager to deliver high 'active share' rather than following the index. We do not construct the portfolio in line with a top down or sector view, but are very cognizant of the need to manage the increased idiosyncratic risk arising from a concentrated basket of stocks.

### HIGH CONVICTION

We take a pragmatic approach to investment management, looking at individual company characteristics as part of our rigorous investment philosophy. As a bottom-up focused investor, we consider many factors to evaluate whether to place a stock in the portfolio. There has to not only be upside return potential, but also improving fundamentals or some other meaningful exogenous event which may cause the market to re-evaluate the company. The fund's high-conviction approach offers the potential to significantly enhance value for shareholders.

### SIZE MATTERS

Academic evidence shows smaller companies have historically outperformed large-cap equities on a risk-adjusted basis. The same effects also persist in mid-caps, where there is potential for a great number of share price catalysts. We believe that investing in under-researched, less well-known companies can add alpha.

### MANAGER TENURE

Fund manager Richard Penny has built a strong track record with more than 20 years of investment experience. Since taking over as lead fund manager of the UK Special Situations Trust, Richard has outperformed in eight out of eleven quarters. He is also co-invested in the fund.

### LGIM CAPABILITIES

As one of the largest institutional asset managers in the UK, LGIM is afforded exceptional access to senior management teams of FTSE companies. Active engagement with management teams provides us with insight into company strategy, corporate governance and industry developments.



**Richard Penny**  
Fund Manager (since May 2014)

Richard joined LGIM in 2003 and is a fund manager on the High Alpha desk. He is the manager of the award-winning L&G UK Alpha Trust and most recently, in May 2014, was also appointed manager of the L&G UK Special Situations Trust. Previously he worked for five years as a fund manager at M&G.

**CONTACT US FOR MORE INFORMATION**

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\*Call costs may vary

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