Flash update: BlackRock Income & Growth

BRIG's balanced, style-agnostic approach could fare well in a 'goldilocks' environment...

Update
05 September 2024

- **Over the last 12 months to 03/09/2024, BlackRock Income & Growth (BRIG) has delivered a NAV total return of 15.5%, broadly in line with the 15.6% return from the FTSE All-Share Index.**

- **Over the long run, however, BRIG has outperformed convincingly. Under the 12-year tenure of co-manager Adam Avigdori, BRIG has delivered a NAV total return of 145.8% to 03/09/2024, compared to the index's 136.9% return.**

- **Adam and co-manager David Goldman anticipate that economic and market volatility will persist throughout the year. However, they are buoyed by the opportunities this could create, and this has prompted them to invest in turnaround stories like testing and verification service provider SGS and cash generative businesses sitting at more attractive valuations such as mining equipment supplier, Weir Group.**

- **The board declared a 2.70p per share interim dividend for the 2024 financial year, up 3.8% compared to the same period in 2023. Strong earnings growth in the portfolio boosted revenue earnings from 3.44p to 3.94p per share, fully covering the interim dividend.**

- **BRIG traded at an average 12.7% discount over its latest half-year results which covered six months to April 2024, prompting the board to buy back 488,228 shares. Since then, its discount has come in slightly, and at the time of writing, BRIG trades at a 10.3% discount. The board have bought back an additional 242,146, or 1.2% of shares since the end of April 2024.**

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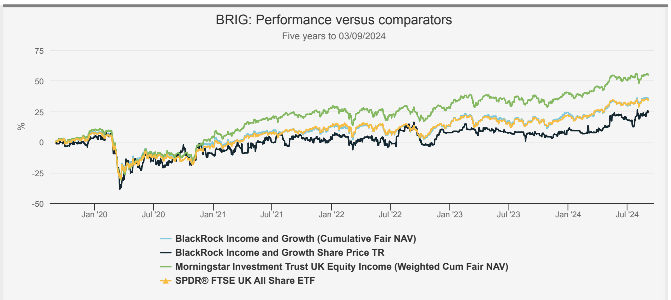
Performance

Over the last 12 months, BlackRock Income & Growth (BRIG) reported a NAV total return of 15.5%, broadly in line with the FTSE All-Share Index's total return of 15.6%. Key contributors this year include Intermediate Capital Group, which performed well following a rise in assets under management. One of the trust's top holdings, 3i Group, also contributed to performance following strong annual results that provided positive news on both current trading and future prospects of its largest asset, Action, the European discount retailer. Additionally, the portfolio benefitted by not owning Diageo or Prudential, both of which saw share prices fall due to weaker trading.

Conversely, some holdings detracted from performance over the reported period. For example, Hays, the staffing company, issued a profit warning following a slowdown in its activities in the latter part of 2023. Adam and David continue to own Hays in the portfolio as they see significant long-term value but acknowledge its current challenges. The portfolio's position in Reckitt, a global leader in consumer health, hygiene and household products, also hurt performance. The company's 2023 results were weaker-than-expected, compounded by a product recall alongside negative news around the emergence of potential litigation action. The managers' reduced their position in Reckitt, given they think issues are likely to persist in the short-term.

Whilst there has been a clear pick-up in performance in 2024, BRIG is marginally behind the index over five-years, as shown below. We think this comes down partly to the portfolio's allocation to the more domestically sensitive smaller companies which suffered from economic pressures, such as high interest rates and inflation. We've also included an ETF tracking the FTSE All-Share Index for comparison. However, long-term performance remains strong and under co-manager Adam Avigdori's 12-year tenure, BRIG has benefitted from the style-agnostic approach which has helped the trust deliver a NAV total return of 145.8%, compared to the index's 136.9% return.

Fig.1: Five-Year Performance



Source: Morningstar

Past performance is not a reliable indicator of future results.

Positioning and outlook

Adam and David note that equity markets entered the year in a buoyant mood following a strong and broad rally in the latter part of 2023, arguing that the outlook, and optimism, is a far cry from 12 months ago. They also argue that markets have entered 'goldilocks' territory whereby slowing inflation has signalled the peak for interest rates whilst broad macroeconomic indicators that have been weak are not expected to deteriorate further.

Both managers are buoyed by the potential opportunities on offer and this optimism has prompted them to add several new positions to the portfolio, including Weir Group, a mining equipment supplier, which boasts good free-cash-flow generation, a healthy balance sheet and modest valuation. They think that Weir has a well-established base that generates significant aftermarket revenue and based on their positive outlook for mining capex moving forward, it could be a company well-placed to benefit in the long run. They also added SGS, a global testing business, to the portfolio, viewing it as a promising turnaround story under its new CEO, who they believe can reinvigorate the organic growth of the business, alongside improving its operational effectiveness.

Additionally, the managers added National Grid to the portfolio, which recently completed a successful rights issue to fund its expanded capex plans over the next five years. With growing regulatory support for electricity transmission, particularly in the UK and US, they argue National Grid is well-placed to benefit, given the pivotal role it plays in the ongoing energy security and transition story.

To fund these changes, they sold positions in Schneider Electric and Centrica following their strong bouts of performance. Both businesses have contributed well to BRIG's performance since their initial purchases, and, with a particularly good run this year, Adam and David felt the risk-reward was now more balanced with better opportunities elsewhere. Performance sales aside, they also exited their position in Watches of Switzerland due to weaker-than-expected demand recovery in China and uncertainty about the company's direction.

Despite the headwinds the UK has faced, Adam and David believe there are plenty of opportunities in the market and are confident in their long-term approach, arguing their focus on quality, cash generative companies with growing dividends and reasonable valuations will help drive returns over the long term. Additionally, favouring a more style-agnostic approach in the current market environment, essentially blending aspects of both growth and value styles, is a more a conducive approach as they believe that pure play style strategies might not continue to drive markets as they have in the past.

Whilst challenges remain, both managers are encouraged that increased M&A and share buyback activity, alongside a steadily improving domestic economy, could be early signs of a potential revival for the UK market amongst investors. For example, a number of high-profile bids for UK companies have been made, most recently for Hargreaves Lansdown, but also for the likes of Anglo American and Currys, which support the growing recognition of value the UK market has on offer.

A combination of the above leads the managers to believe that we could be on the cusp of a revival for the UK stock market, however, they think that predicting when and how that revival will build momentum is difficult. As such, they continue to stick to their investment process, targeting quality businesses that demonstrate sustainable free cash flow, which, in their eyes, can provide a measure of stability and predictability in various market cycles.

Kepler View

For years, the UK stock market has been perceived as cheap and home to downtrodden sectors that have struggled over the last decade. However, investor sentiment appears to be shifting as the UK economy has started to demonstrate real signs of life. Supply chains disruptions have eased somewhat, the eye-watering double-digit inflation has fallen and the Bank of England cut interest rates for first time since March 2020.

The backdrop is an economy that is beginning to grow, albeit slower than we all might like, but a marked improvement from the worrisome quarterly gross domestic product figures reported over 2023. In the first two quarters of 2024, the UK economy has reported 0.7% and 0.6% growth, respectively, and its stock market, notably the FTSE 100, hit a record high in April, fuelled by renewed optimism around its economic recovery. Yet, the UK stock market continues to remain depressed in valuation terms relative to other developed markets, something that's sparked increased M&A activity, reflecting the recognition from institutional buyers that there is value to be taken in the market.

Whilst both of BRIG's managers remain cautiously optimistic, they are also taking advantage of the opportunities, sticking to the process and investing in attractively valued companies demonstrating good cash generation alongside durable, competitive advantages that provide some resilience in market swings. They are also focusing on investing in companies, across the market cap, with growing dividends preferring those with sustainable, long-term growth prospects over those offering the highest immediate yields, that might not be sustainable or offer the prospect for future growth.

In our view, BRIG's investment process offers a more balanced factor approach than many peers in the sector, blending aspects of value and growth strategies, whilst also emphasising a focus on quality and growing dividends. We think this approach could be effective in the current market environment, particularly if pure play value and growth strategies no longer drive market performance as much as they once did. Consequently, BRIG's discount, which is wider than its five-year average, could provide investors with a potentially attractive entry point for more balanced exposure to the UK, with a preference to quality businesses with growing dividends.

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