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Strategic Equity Capital plc

Factsheet commentary – Q2 2023

Past performance is not necessarily a guide to future performance. Portfolio investments in smaller companies typically involve a higher degree of risk. Capital at risk. Extracted portfolio performance is not necessarily indicative of the performance of the fund. Not to be construed as investment advice or a recommendation.

Overview

Following a turbulent Q1 2023, which included the collapses of Silicon Valley Bank, Credit Suisse and several US regional banks in close succession, fuelling fears of widespread banking sector contagion, Q2 2023 began with softer levels of risk sentiment.

Key macroeconomic headwinds in the first two months of the quarter included the protracted discussions around raising the US debt ceiling and fears of a technical default, signs of weakness in China's economic recovery, and confirmation that Germany had entered into recession.

The latter end of the quarter saw a divergence in risk appetite between UK equities and most major global markets, as domestic macroeconomic headwinds contributed towards neutral/negative performance in UK equity indices in June, in contrast to the positive performance delivered by most major global indices in the same period.

Offsetting the negative macroeconomic sentiment were a number of positive UK economic developments including growing consumer confidence, continued Sterling strengthening (in particular vs. the Dollar) and continued decline in wholesale Natural Gas prices, the latter two in particular which should help alleviate UK inflation pressure going forward.

Despite the challenging environment, we remain confident that our portfolio of businesses has strong fundamental characteristics, with most companies exposed to resilient structural growth trends or self-help opportunities and therefore able to perform well despite the wider macroeconomic uncertainty. We also continue to avoid investing in companies and sectors that we believe are disproportionately exposed to macroeconomic cycles and other exogeneous factors, for example banks, oil & gas and mineral companies.

News flow across our portfolio companies has on the whole been positive and well received by the market, with a number of trading updates demonstrating better than expected financial performance.

The longer-term discounted valuations applied to UK equities, and in particular the smaller companies segment, remains material, and this is reflected in recent levels of takeover activity. Following an active start to the year for UK takeovers, Q2 2023 demonstrated continued frequency of takeover activity.

We remain selective and disciplined in our approach, seeking high-quality companies with attractive long-term sustainable capital growth characteristics at sensible valuations.

Performance[1]

The Trust's NAV Total Return increased by 8.8% over the quarter, outperforming the FTSE Small Cap Index

1. Where holdings' returns are stated, please note these are Total Returns, including dividends, for each of those stocks over the quarter
2. Not official benchmark, used for comparative purposes only

(excluding Investment Companies)[2] which increased by 1.0% and beating the UK Smaller Companies Investment Trust sector which decreased by 0.3%.

Key contributors to returns in the quarter to 31 June 2023 came from: **Medica Group** (+36%), following the Recommended Cash Offer from IK Partners, a European private equity firm, at a 32.5% spot premium; **XPS Pensions Group** (+9%), which demonstrated strong current trading and outlook and delivered results in excess of market expectations, resulting in analyst upgrades; and **Brooks Macdonald** (+17%) following the announcement of a quarterly increase in AUM along with the appointment of a new CFO.

The main detractors in the period were: **R&Q Insurance Holdings** (-29%), following the announcement of its intention to separate its two businesses, and the issuance of a preferred equity instrument to bolster capital adequacy to facilitate this process; we view these developments positively as they provide a pathway to unlock the sum of the parts discount that was central to our investment thesis; **Wilmington** (-8%) and **Hostelworld** (-4%), both on no particular news.

Portfolio activity

The Trust made no new investments during the quarter.

The Trust made one full exit in the quarter, from **Idox**, which had performed well since the Trust's investment in 2021. Whilst we still view Idox as a well managed business with a credible growth strategy, we saw an opportunity to redeploy capital into some relatively more attractive pipeline opportunities.

Outlook

We continue to expect that market conditions will remain volatile throughout the second half of 2023, with a particular focus on the UK's inflation trajectory and implications for, inter alia, the monetary policy path. However, the Trust remains well positioned, with a portfolio of relatively resilient businesses, exposed to structural growth trends and with strong fundamental characteristics, that we believe should perform well through the cycle.

While we view the outlook with suitable caution, we expect heightened volatility to drive attractive long-term investment opportunities and we remain vigilant for evidence of mispricing. We remain selective and disciplined in our approach, seeking high-quality companies with attractive long-term sustainable capital growth characteristics at sensible valuations.

As already supported by announcements during the first half of the year, which continued at pace during Q2 2023, we expect to see further takeover activity amongst listed UK companies in the second half of the year, as corporate and private equity buyers seek to benefit from ongoing dislocation between strong company fundamentals and UK equity valuations. Significant levels of capital yet to be deployed by private equity firms could continue to provide a supportive landscape for elevated corporate activity over the short-medium term.

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