

LF Gresham House UK Smaller Companies Fund

Factsheet commentary – August 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. Views expressed by the investment team are correct at the time of writing but are subject to change.

Overview

Following low but positive returns in July, the FTSE Small Cap (excl. IT) and AIM All Share indices fell in August as ongoing macroeconomic uncertainty was reflected in weaker monthly PMI and consumer spending data. Markets expect further Base Rate rises between now and early 2024, compounding recessionary fears as the effects of monetary policy seep through to consumption and investment activity. More positively, M&A activity continued across the UK market, providing further evidence of the current disconnect between underlying company fundamentals and stock market valuations. While risk appetite remains subdued, we are seeing buying opportunities which offer compelling potential for long-term shareholder value creation.

We remain confident in the fundamentals of our portfolio, with many holdings benefitting from structural growth tailwinds or self-help initiatives. Moreover, our portfolio businesses operate within specialist market niches protected by high barriers to entry, underpinning their potential for earnings growth and cash generation throughout the cycle.

News flow across the portfolio was broadly positive in August, with several companies delivering strong interim results: c.84% of company updates in the Fund during the year-to-date have been in-line or positive versus market expectations, with their full-year numbers looking increasingly secure as these businesses enter the second half of the year.

Idea-generation and pipeline remained robust in August as current conditions have presented opportunities to invest in businesses with high-quality fundamentals at attractive entry points, and we continue to undertake latter-stage due diligence on a number of investment ideas.

Performance¹

The LF Gresham House UK Smaller Companies Fund decreased by 1.03% during the month, outperforming the IA UK Smaller Companies sector which decreased by 2.16%.²

Key positive contributions came from **EMIS Group** (+32%) following the provisional CMA approval of its takeover by United Health which had been under regulatory review; **Sabre Insurance** (+11%), following well received interim results and corresponding analyst upgrades, primarily driven by rising insurance premia and

1. Please refer to the factsheet for full UCITS-compliant performance figures.

2. The IA UK Smaller Companies sector comparator is used for illustrative purposes only.

rationality returning to the market; and **Franchise Brands** (+12%), following the release of interim results which showed strong revenue growth following the acquisition of Pirtek.

The largest detractors to performance were **Capita** (-32%) following the release of interim results which were broadly in line, but with weaker than expected cashflow, driven primarily by one-off costs; and **Ricardo** (-10%), following the release of an in-line Full Year 2023 trading update, which indicated some downward pressure on outer year forecasts due to higher interest costs.

Portfolio activity

We made no new investments during the period; however, we made selective follow-on investments into several companies.

We upweighted our position in **Essentra**, an international manufacturer and distributor of components into a diverse range of industrial supply chains, which has a clear growth strategy and a high-quality management team focused on cost discipline. We also increased our stake in **Team 17 Group**, an independent video game developer and publisher, which the Manager believes is well positioned despite the difficult backdrop in the video games market.

We made one full exit during the period, from **Flowtech** (-30%) following a fundamental shift in the Manager's view of the investment thesis, after the release of a profit warning during the period.

Outlook

While we expect monetary policy and recessionary fears to dampen consumer and investor sentiment for the remainder of the year, we retain high conviction in the quality and resilience of our portfolio companies. Due to their strong fundamentals and exposure to structural growth trends, these businesses are well-positioned to mitigate near-term macroeconomic headwinds and potentially perform throughout the cycle.

Furthermore, we expect depressed market conditions to cultivate a high frequency of mispricing and opportunity, as it has done throughout the year to date. Our idea generation and vigorous due diligence processes allow us to locate high-quality companies with long-term capital growth potential at sensible valuations.

With private equity still needing to deploy excess capital, we expect to see elevated M&A activity as an ongoing theme of 2023. Last month we saw additional evidence of buyout firms capitalising on the dislocation between strong company fundamentals and UK equity valuations, with a number of further takeover approaches announced. As such, we see the present market landscape as supportive of further corporate activity in the coming months.

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Funds investing in smaller companies may carry a higher degree of risk than funds investing in larger companies. The shares of smaller companies may be less liquid than securities in larger companies.

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