Gresham House
Specialist asset management

Strategic Equity Capital plc

Factsheet commentary – Q3 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 a turbulent H1 2023, which included the US regional banking crisis, collapse of Credit Suisse, weak Chinese economic data and continued recession in Germany, Q3 showed mixed results in terms of macroeconomic backdrop. On the one hand, the UK started to show signs of disinflation which alleviates prior returns about persistent inflation, in addition to positive GDP revisions which suggest that the UK economy recovered from COVID better than previously expected. On the other hand, bond yields (in the UK and globally) have risen further as investors increasingly accept the "higher for longer" narrative. The net effect of the above saw continued outflows from UK equities in Q3 2023.

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.

Newsflow 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, Q3 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 decreased by 2.5% over the quarter, underperforming the FTSE Small Cap Index (excluding Investment Companies)[2] which increased by 2.9% and lagging the UK Smaller Companies Investment Trust sector which increased by 0.8%.

Key contributors to returns in the quarter to 30 September 2023 came from: **XPS Pensions Group** (+15%), which demonstrated strong current trading and outlook following the announcement of a new key strategic partnership; **Tribal Group** (+38%), after the publication of interim results that were materially ahead of market expectations; and **Wilmington** (+16%) as a result of updated earnings guidance which advised both revenue and profit growth.

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

The main detractors in the period were: **Inspired** (-30%), despite the release of in-line interim results; **Brooks Macdonald** (-21%) on the back of broader market concerns around potential sector-wide outflows, despite the release of FY23 results slightly ahead of consensus expectations; and **Ricardo** (-13%), 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

The Trust made one new investment during the quarter, into **Trufin,** a provider of financing and payment services as well as working capital finance and technology solutions to SMEs.

The Trust made two full exits in the quarter, from **Media Group (25%)**, following the completion of the previously announced Recommended Cash Offer from IK Partners, a European private equity firm; and **Carr's Group (18%).** Carr's Group was a new investment earlier this year. However, following challenges in some of the company's end markets, and an unexpected change in management, the Manager reassessed the medium term outlook for the company and decided to exit the investment to focus on more attractive risk/reward opportunities elsewhere.

Outlook

While UK equity markets remain depressed on the back of persistent macroeconomic uncertainty, we retain high conviction in the fundamental quality and resilience of our portfolio businesses. We believe the growth trajectories of our portfolio companies are, in the main, insulated from cyclical pressures due to their exposure to structural growth themes.

Our unique and repeatable investment process, driven by a strong focus on company fundamentals, optimally positions our fund to capitalise on the elevated frequency of mispricing we are seeing across UK equity markets. We continue to locate high-quality companies with long-term capital growth potential at attractive valuations.

Moreover, we expect sustained M&A activity to characterise the remainder of 2023 as private equity looks to deploy excess capital. At present valuations, companies in our investible universe are becoming increasingly attractive to leveraged buyers despite higher interest costs, and we think M&A will play an important role in reminding investors of the value creation potential offered by UK public markets.

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