Gresham House
Specialist asset management

LF Gresham House UK Smaller Companies Fund

Factsheet commentary - January 2022

Overview

January continued recent themes, with an increasing level of market volatility driven by sustained supply chain shortages across the UK and ongoing negative sentiment surrounding inflationary pressures. Despite this backdrop, equity issuance remained relatively active, with a few smaller companies issuing new equity, and some IPO activity continuing, although at a more moderate level than last year.

The increased volatility and weaker sentiment is justifying the longer-term opportunity in UK smaller companies - underpinned in particular by the continuing discounted valuations applied to UK and smaller companies, which remains material. We believe this environment is supportive of finding attractive investment opportunities.

Such a dynamic market environment leaves our bottom-up, stock selection-based approach well placed to identify opportunities through quantitative screens and our industry network. Over the past few months, a number of opportunities have entered the pipeline on a free cash flow yield basis or where fundamentally good business models (defined by operating margins and ROCE) have seen their shares fall over 50% - they were either too expensive before or are too cheap now; we believe the reality on average will be somewhere in between across a range of opportunities to now acquire 'good shares' in 'good companies'. We remain selective and disciplined in our approach, seeking high-quality companies with attractive long-term capital growth characteristics at sensible valuations.

Performance

The LF Gresham House UK Smaller Companies Fund (the Fund) delivered a return of -5.4% during the month compared to the IA UK Smaller Companies sector which decreased by 7.7% and the NSCI + AIM (ex IC) index which decreased by 6.4%.

Key contributions came from **Sabre Insurance** (+20%), after announcing a new five-year contract with Freeway Insurance Services; **Devro** (+10%), after a positive trading update; and **Ten Entertainment** (+6%), after a very strong trading update.

The largest detractors to performance were **IG Design Group** (-62%), after reporting in its trading update that supply chain disruptions resulted in fulfilment-related cost premiums being incurred; **Accrol** (-43%), after reporting in its trading update that inflationary pressures continue to impact input costs; and **Liontrust** (- 27%), due to its listed equity market exposure as a UK asset manager. Both IG and Accrol are now under review.

Portfolio activity

The Fund made one new investment into **Medica Group**, a company that provides radiology services. The shares are priced attractively on a number of quantitative metrics and we believe the increased exposure to healthcare is attractive in the current macro environment, with additional tailwinds created by the need to clear the NHS backlog. The Fund also made a number of follow-on investments into existing portfolio holdings, including **FRP Advisory**, **Inspired**, and **Premier Foods** amongst others. The fund also made one full exit during the period, Young and Co's Brewery (-7%).

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Outlook

Our medium-term view remains that the economic recovery in the UK should continue to support earnings growth and share prices overall, but stronger management teams and business models are expected to outperform as all companies navigate an inflationary environment with elements of consumer weakness and supply-side issues.

As a result of this, we continue to expect volatility in the short term driven by an inherently uncertain environment for market estimates and the trajectory of central bank policy. This in turn is likely to exacerbate share price volatility for individual stocks

Important information