Gresham House
Specialist asset management

LF Gresham House UK Micro Cap Fund

Factsheet commentary - April 2022

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.

Overview

April continued to see further falls in equity markets amid ongoing volatility-driven negative sentiment on inflationary pressures, interest rate rises, cost of living squeeze in the UK and a return of lockdowns in China. The ongoing war in Ukraine continues to weigh on global equity markets, being particularly pronounced in UK and European equities.

We have been anticipating increasing market and stock level volatility for some time and believe our portfolio is set up to deliver long-term resilient capital growth opportunities. Over the past 12 months, we have been increasing our focus on businesses with greater earnings resilience in line with our core investment strategy, which has delivered well so far on a relative basis at least. The Free Cash Flow (FCF) yield and EBITDA margins of the portfolio are now well above market averages, and leverage is lower.

Despite the increased volatility, we continue to believe that the longer-term opportunity within small cap UK equities, underpinned by the persistent discounted valuations applied both to the UK but more accentuated within the smaller companies segment, remains material.

Notwithstanding the fast-moving geopolitical situation, such periods of short-term volatility typically lend themselves to finding attractive investment opportunities for those prepared to take a longer-term view. We remain selective and disciplined in our approach, seeking high-quality companies with attractive long-term sustainable capital growth characteristics at sensible valuations.

Performance

The LF Gresham House UK Micro Cap Fund decreased by 0.8% during the month, compared to the IA UK Smaller Companies sector which decreased by 2.0% and the NSCI + AIM (ex IC) Index which decreased by 1.6%.

Key contributions came from **Alpha FMC** (+36%), on the back of a positive trading update with results ahead of expectations; **XPS Pensions Group** (+12%), following a positive trading update; and **Diaceutics** (+18%), on no specific news.

The largest detractors to performance were **Kape Technologies** (-28%), which was de-rated along with the technology sector despite strong recent results, **Mattioli Woods** (-8%%), and **Staffline** (-10%) both of which de-rated on no specific news.

Portfolio activity

We made three follow-on investments: into **Inspired**, an energy procurement consultancy; **TruFin** which provides software and services to FinTech and banking businesses; and **Diaceutics** a supplier of pharmaceutical data analytics products and services.

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Outlook

Aftershocks from the pandemic that emerged during the start of this year, such as elevated inflation across a number of areas and global and domestic supply chain disruption, have been exacerbated by the Russia / Ukraine crisis. This has caused acute dislocations in asset classes globally and deteriorating market sentiment which continued through the period.

However, we believe our portfolio of high-quality businesses with resilient growth fundamentals and robust income streams is well positioned to deliver good long-term returns. In this period of higher uncertainty, we continue to apply our disciplined investment process and selectively seek out structurally attractive long-term investment opportunities that we believe have the ability to outperform through different and evolving market cycles.

Our medium-term view remains that the economic recovery in the UK should continue to support earnings growth and share prices. However, we continue to expect volatility in the short term, driven by an inherently uncertain environment for market estimates. We also anticipate a rising number of profit warnings in coming months. This in turn is likely to exacerbate share price volatility for individual stocks.

We believe stock-level volatility across the market, while creating some challenges, will provide an attractive environment for investors to back quality companies with attractive long-term structural capital growth at reasonable valuations across the market cap spectrum. The economic environment and market discontinuity will provide agile smaller businesses with strong management teams the opportunity to take market share and build strong, enduring franchises.

The elevated levels of corporate activity within the UK equity space continue to play out. We believe our investment process and private equity lens across public markets position us well to identify investment opportunities with potential strategic value that could be attractive acquisitions for both corporate and financial buyers.

We continue to believe that over the long term our fundamentals-focused investment style has the potential to outperform. The Fund will maintain its focus on building a high-conviction portfolio of less cyclical, high-quality businesses with stable and growing earnings streams, and good cash flows. We believe these businesses can deliver strong returns through the market cycle regardless of the performance of the wider economy.

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