Gresham House
Specialist asset management

LF Gresham House UK Smaller Companies Fund

Factsheet commentary - May 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

May continued to see further equity market volatility as negative sentiment on inflationary pressures, interest rate rises and the cost-of-living squeeze were all exacerbated by the prospect of a protracted conflict in Ukraine.

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 we expect to support relative performance in comparison with the wider market and deliver absolute performance over the long term.

The portfolio now offers attractive quality aggregate financial metrics (higher growth rates, higher margins, higher returns, lower capital Intensity and lower financial leverage) at a reasonable valuation relative to the wider market.

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 Smaller Companies Fund decreased by 2.0% during the month, compared to the IA UK Smaller Companies sector which decreased by 2.6% and the NSCI + AIM (ex IC) Index which decreased by 1.7%. The fund continues to perform very strongly on a relative basis versus its peers and the comparator index, though absolute performance remains tough in the current environment.

The largest detractors to performance were **Randall & Quilter** (-29%), following the termination of a takeover bid, **Loungers** (-20%) and **LSL Property Services** (- 13%), on no specific news.

Key positive contributions came from **FRP Advisory** (+25%), on the back of a positive trading update with results ahead of expectations; **Balfour Beatty** (+8%), following a positive trading update; and **Euromoney** (+9%), on no specific news. This was particularly pleasing as FRP and Euromoney were a new investment or significant upweight respectively during the year.

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Portfolio activity

We made a number of follow-on investments into existing portfolio holdings, including **Euromoney**, **Telecom Plus**, and **The Gym Group** amongst others.

We made one full exit, specialist financial services group **Close Brothers** (-19% return), and a number of partial exits including **River & Mercantile**, where we received cash from the sale of their Solutions business.

Clipper Logistics, a warehousing, garment handling and transport services company was acquired during the month with new shares in **GXO Logistics** being received as a small component of the overall consideration. These shares in GXO Logistics have subsequently been sold.

Outlook

Aftershocks from the pandemic that emerged at the start of the 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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