

LF Gresham House UK Micro Cap Fund

Factsheet commentary - August 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. Extracted portfolio performance is not necessarily indicative of the performance of the fund.

Overview

Lower market volatility over the summer compared with earlier in the year and something of a market rally in July and the first part of August gave way to a retrenchment into lower risk appetite as ongoing concerns around inflationary pressures, interest rate rises and the cost-of-living squeeze on households once again became front of mind for investors.

Predictions of ever-increasing headline short-term inflation rates as well as ongoing energy market volatility has started to weigh on business confidence with the focus on energy prices expanding from consumers to the impact on the viability of many smaller businesses. A new UK Prime Minister, announced after the period end, has fuelled expectations of an imminent large government intervention to alleviate these issues but the scale required has in turn spooked FX and bond markets, driving Sterling lower and Gilt yields higher.

Our default assumption for the remainder of the year is "more of the same". We expect macroeconomic and geopolitical factors to drive sentiment and in turn create market and stock level volatility. During 2022, we have focused on undertaking an in-depth, bottom-up risk review of the portfolio in the context of the economic headwinds in the market. This has driven some changes to portfolio weightings but largely has confirmed our view that the Fund is well positioned with a portfolio of relatively resilient businesses exposed to structural growth trends and with robust financials and low financial leverage.

Whilst mindful of the shifting economic paradigm and the risks that all companies face, we are confident in how robust the business fundamentals are in the majority of our portfolio companies, as well as the margin of safety on valuation relative to our view of long-term fundamental value.

Despite the uncertain environment, 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.

We remain selective and disciplined in our approach, seeking high-quality companies with attractive long-term sustainable capital growth characteristics at sensible valuations.

Performance¹

The LF Gresham House UK Micro Cap Fund decreased by 2.52% during the month, outperforming the IA UK Smaller Companies sector which decreased by 4.72%.

1. For complete performance, please refer to the factsheet

Key contributions came from **Ricardo** (+14%) which re-rated on the news of a takeover approach for listed peer RPS Group at a premium valuation multiple; **Tortilla Mexican** (+13%) after reporting significant growth and positive trading despite the challenging market environment; and **Elixir International** (+9%), following a director share sale to provide liquidity for institutional demand for the shares.

The largest detractors to performance were **Gym Group** (-21%) and **Windward** (-21%) which both de-rated on no specific news; and **Angling Direct** (-19%) which fell following a trading update and downgraded full-year earnings forecasts.

Portfolio activity

We made no new investments in the period, however we made some selective follow-on investments into existing portfolio holdings, including **Medica Group**, **EKF Diagnostics**, **Frenkel Topping** and **Angling Direct**.

There were no full exits during the period, but we top sliced and took some profits from a number of the larger portfolio holdings including **Tatton**, **XPS Pension Group** and **Franchise Brands**.

Outlook

The macroeconomic and equity market outlook continue to exhibit elevated levels of uncertainty as we appear to be at a generational paradigm shift from low to higher inflation and low interest rates to a sustained period of increasing rates and unwinding of government stimulus as well as an equity rotation from growth to value that is well underway.

We anticipate this uncertainty will continue to drive periods of sentiment driven volatility in equity markets well into next year. While we view this outlook with suitable caution, we also expect heightened volatility to drive attractive long-term investment opportunities and we remain vigilant for evidence of mispricing.

We believe our portfolio of high-quality businesses with resilient growth fundamentals is well positioned to deliver 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.

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