

LF Gresham House UK Micro Cap Fund

Factsheet commentary - September 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

A post-summer return of market volatility was exacerbated by the new UK Government's "mini-budget", which combined unfunded tax cuts and energy market support measures that led to a gilt market sell off, crisis in the pensions market and led the Bank of England to intervene to stabilise bond markets.

These events weighed on risk appetite and increased the perceived cost of capital, which put pressure on equity markets. Sentiment remains fragile and ongoing global geopolitical tensions remain an additional ongoing risk.

Higher gilt yields and weaker Sterling continue to stoke inflation in parallel with softening economic activity adding to the uncertainty for businesses and consumers as we head towards a winter of discontent. It seems inevitable that market conditions will remain volatile for the remainder of the year and well into next year.

Despite the seemingly bleak environment, we remain confident that our portfolio of businesses has strong fundamental characteristics, with the majority of companies exposed to resilient structural growth trends or self-help opportunities, and can therefore continue to perform well despite the wider macroeconomic uncertainty. Valuations are undemanding for this set of quality fundamentals.

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. Currency movements have enhanced this valuation anomaly from the perspective of overseas buyers which is likely to support a resurgence in takeover activity amongst listed UK companies.

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 6.73% during the month, outperforming the IA UK Smaller Companies sector which decreased by 9.12%.²

Key contributions came from Argentex (+12%) which reported strong results and consequent forecast upgrades; Costain (+4%) after announcing the appointment of a new Chair; and Windward (+5%) after announcing positive half year results.

The largest detractors to performance were R&Q Insurance (-28%) due to ongoing uncertainty around

1. Please refer to the factsheet for full UCITS-compliant performance figures.

2. The IA UK Smaller Companies sector comparator is used for illustrative purposes only.

board composition and governance; Netcall (-12%) which de-rated on no specific news; and Medica Group (-13%) which fell despite following interim results which indicated full year margins would be weaker than expected.

Portfolio activity

We made no new investments in the period. However, we made some selective follow-on investments into existing portfolio holdings, including EKF Diagnostics and AdvancedAdvT.

There was one full exit during the period, musicMagpie (-71.48%), and partial sales from Kape Technologies and Knights Group.

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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