Strategic Equity Capital plc

Factsheet commentary – Q3 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

The quarter started with more benign market conditions and some respite following a challenging first half of 2022 for UK equities. However, late summer saw a return of market volatility, 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 with the Bank of England intervening to stabilise bond markets. These events have 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.

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. 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.

Performance[1]

The Fund NAV Total Return decreased by 8.9% over the quarter, marginally outperforming the FTSE Small Cap Index (excluding Investment Companies)[2] which decreased by 9.0% and in line with the UK Smaller Companies Investment Trust sector which also declined by 8.9%.

Key contributors to returns in the quarter to 30 September 2022, came from: **Wilmington** (+13%), a provider of regulatory driven data and training solutions, following strong full year results; **Ricardo** (+27%), an automotive and environmental consultancy, which announced strong full year results as well as the appointment of a new Chairman; and **XPS Pensions Group** (+2%), an actuarial services provider, which announced the earnings enhancing acquisition of Penfida Limited, a leading independent corporate finance and covenant advisor to UK pension funds.

1. Where holdings' returns are stated, please note these are Total Returns, including dividends, for each of those stocks over the quarter
2. Not official benchmark, used for comparative purposes only

The main detractors in the period were: **Tribal Group** (-21%), an international provider of student administration software, which announced a decline in pre-tax profits for the first half of the year; **Inspired plc** (-20%), a UK B2B corporate energy services and procurement specialist, despite announcing a half year trading update in line with the Board's expectations; and **LSL Property Services** (-21%), a leading provider of services to the UK residential property sector, which de-rated on market concerns about a deteriorating outlook for the UK housing market.

Portfolio activity

The Fund made follow-on investments into **R&Q Insurance Holdings** and **Fintel**.

The fund fully exited **Tyman**, realising proceeds of £6.6mn and 23% IRR.

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.

Important information

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