LF Gresham House UK Smaller Companies Fund

Factsheet commentary - October 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

The UK political turbulence continued into October, following the September 'mini-budget' that resulted in a new Prime Minister and Chancellor. This injected a degree of short-term stability back into markets after the previous month's gilt market sell off, crisis in the pensions market and Bank of England intervention to calm bond markets.

Notwithstanding the consequent upward correction in sterling and UK equity markets during the month, the wider economic backdrop and longer-term challenges remain. Concerns around high inflation, rising interest rates and a pervasive cost of living crisis linger. With the reality of a softening economic environment continuing to weigh on businesses and consumers, we view pockets of market optimism as being short-lived. Broadly, sentiment remains fragile and ongoing global geopolitical tensions are an additional ongoing risk.

It seems inevitable that market conditions will be 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 most companies exposed to resilient structural growth trends or self-help opportunities and therefore able 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 and sustainable income characteristics at sensible valuations.

Performance[1]

The LF Gresham House UK Smaller Companies Fund decreased by 0.54% during the month, underperforming the IA UK Smaller Companies sector which increased by 2.17%.[2]

Key positive contributions came from **Halfords Group** (+36%), following a well-received acquisition and corresponding broker upgrade; **Telcom Plus** (+24%), following a trading update materially ahead of market

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.

expectations; and **Liontrust** (+18%), following a broker upgrade.

The largest detractors to performance were **Watkin Jones** (-22%) following a profit downgrade due to short-term contract delays; **Kape Technologies** (-17%) which derated on no specific news; and **DWF Group** (-18%), also down on no specific news.

Portfolio activity

We made one new investment during the period, into **DWF Group**, a legal services firm where we see significant upside from the latter stages of a material turnaround of the business under the current management team. We also made a number of follow-on investments into existing portfolio holdings during the month, including **Ricardo, Medica Group**, and **Watkin Jones**. There was one full exit during the period, **Coats Group** (-10.5% return) as a result of a review triggered by our risk assessment framework which concluded that on balance an increasing risk profile did not justify the current valuation.

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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