Strategic Equity Capital plc

Factsheet commentary – Q4 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

To describe the final quarter of 2022 as eventful would be an understatement. The political turmoil in the UK and the disastrous "mini budget" have been well documented and debated by commentators. The resulting debt market turmoil and liquidity squeeze catalysed a decisive shift in market paradigms with the regime of "easy money", in place since the Global Financial Crisis of 2008, finally coming to an end. We have entered a paradigm of higher inflation and higher rates with profound implications for the economic environment and the valuation of asset markets. After the October maelstrom followed by November's upward correction in Sterling and UK equity markets, December saw greater stability. This more benign environment appears to have continued into the early part of 2023 but given the sheer scale of the global macroeconomic and geopolitical uncertainties we anticipate periods of enhanced market volatility and fragile sentiment this year with the associated challenges and opportunities for equity investors.

Despite the challenging 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 to the UK, but more accentuated within the smaller companies segment, remains material.

Currency movements during 2022 have enhanced this valuation anomaly from the perspective of overseas buyers. This combined with the still significant level of private equity "dry powder" and more stable debt markets lead us to conclude there is a high probability we will see a resurgence in takeover activity amongst listed UK companies during 2023.

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 Trust's NAV Total Return increased by 2.4% over the quarter, underperforming the FTSE Small Cap Index (excluding Investment Companies)[2] which increased by 8.8% and lagging the UK Smaller Companies Investment Trust sector which increased by 8.6%.

Key contributors to returns in the quarter to 31 December 2022, came from: **Hostelworld** (+57%), a hostel focused online travel agent, following strong results and an improving outlook for 2023; **Wilmington** (+22%), a provider of business information and training & education solutions, following strong results and forecast upgrades; and **Fintel** (+19%), a software, services and data provider to the wealth management sector, following the expansion of a key strategic partnership with Schroders.

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: **Inspired** (-38%), a UK B2B corporate energy services and procurement specialist, which de-rated on no specific news; **Tribal Group** (-32%), an international provider of student administration software, following a profit downgrade resulting from an onerous contract; and **Iomart Group** (-23%), an information technology and cloud computing company, following annual results at the lower end of market expectations.

Portfolio activity

The Trust made one follow on investment, into **Ricardo**, an automotive and environmental consultancy and took some profits from our holding in **Wilmington** following strong share price performance**.**

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 playing out.

We expect this uncertainty will continue to drive periods of sentiment-driven volatility in equity markets well into next year. Looking forward we believe it is prudent to expect a tightening environment as businesses and consumers are likely to remain cautious about discretionary costs and spending. We reiterate our continuing focus on resilient companies with business-critical propositions and robust operating and financial models that can deliver through taking advantage of structural tailwinds that are more insulated from the external environment.

While we view the outlook with suitable caution, we 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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