Gresham House
Specialist asset management

LF Gresham House UK Micro Cap Fund

Factsheet commentary – January 2023

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

2023 started with a positive resurgence in market sentiment and performance across UK equities following a flatter end to 2022, as activity and trading volumes returned to the market. Despite this perceived renewed optimism, we are cautious in our expectations around its longevity.

We believe the wider economic backdrop remains highly uncertain and longer-term challenges persist. 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 sentiment, we view pockets of market optimism as being short-lived. Broadly, market conditions remain fragile and global geopolitical tensions are an additional ongoing risk.

Performance[1]

The LF Gresham House UK Micro Cap Fund increased by 6.44% during the month, outperforming the IA UK Smaller Companies sector which increased by 3.26%.[2]

Key contributions came from **Diaceutics** (+41%) following a positive trading update with revenue materially ahead of expectations; **Inspired** (+42%) following an in-line trading update, with momentum in Optimisation and ESG providing the board with confidence going into FY23; and **Medica Group** (+18%) following a well-received trading update, which confirmed that previously announced capacity constraints had been temporary and subsequently alleviated.

The largest detractors to performance were **Windward** (-5%) following the release of its FY22 trading update, which indicated a greater than expected EBITDA loss; and **EKF Diagnostics** (-13%) on no specific news during the period, although it announced downgraded earnings estimates post month end.

Portfolio activity

We made no new investments in the period.

We made selective follow-on investments into a number of existing portfolio companies, including **Oxford Metrics**, an intellectual property rich business that sells hardware and software solutions into a range of applications, with a core competency in motion measurement; the Manager viewed the business as materially undervalued with attractive structural market dynamics; **Gym Group,** a low cost gym operator across the UK which has faced persistent downwards pressure on its share price despite strong business fundamentals, providing an attractive entry point; and **TruFin,** a provider of financing services to fintech and banking businesses, which recently received a bid for one of its business units which highlighted the relative undervaluation of the business as a whole.

There were no full exits during the period.

Outlook

It feels prudent to expect that market conditions will continue to be volatile throughout 2023, particularly as recessionary pressures could weigh on corporate earnings. However, the fund remains well positioned despite the macro-backdrop, with a portfolio of relatively resilient businesses, exposed to structural growth trends and with strong fundamental characteristics, that we believe should perform well through the cycle.

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 during 2022 enhanced this valuation anomaly from the perspective of overseas buyers, which has the potential to support a resurgence in takeover activity amongst listed UK companies as 2023 progresses.

Other factors that provide a supportive landscape for ongoing elevated corporate activity include significant levels of capital yet to be deployed by private equity firms, ongoing dislocation between company fundamentals and listed valuations, and a general prudent re-basing of market expectations.

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

Important information

performance is not indicative of future results. Funds investing in smaller companies may carry a higher degree of risk than funds investing in larger companies. The shares of smaller companies may be less liquid than securities in larger companies. No person, especially those who do not have professional experience in matters relating to investments, must rely on the contents of this Document. If you are in any doubt as to the matters contained in this Document, you should seek independent advice where necessary. This Document has not been submitted to or approved by the securities regulatory authority of any state or jurisdiction. This Document is intended for distribution in the United Kingdom only. Any dissemination or unauthorised use of this Document outside the United Kingdom by any person or entity is strictly prohibited.

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