

Strategic Equity Capital plc

Factsheet commentary – Q1 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. Not to be construed as investment advice or a recommendation.

Overview

Following a period of political and economic turbulence in the latter stages of 2022, which included the infamous “mini budget”, LDI crisis, inflation and interest rate headwinds and cost of living fears, 2023 began with “risk off” sentiment and equity market volatility. This was compounded in Q1 2023 by the collapses of Silicon Valley Bank and Credit Suisse in close succession, which led to fears of a more widespread banking sector contagion. Whilst our portfolio contains no direct exposure to banking institutions, in line with our investment strategy, we were not wholly immune to the global softening of risk appetite.

Offsetting this were a number of positive UK economic developments, including signs of inflation and the cost-of-living crisis easing, a positive January GDP surprise (announced in March), and Sterling strengthening (in particular vs. the Dollar). We maintain our view that the UK’s resilient fundamentals, well-regulated banks and capital markets, and robust corporate earnings may lead to improving sentiment.

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.

News flow across our portfolio companies has on the whole been positive and well received by the market, with a number of trading updates demonstrating better than expected financial performance.

The longer-term discounted valuations applied to UK equities, and in particular the smaller companies segment, remains material, and this is reflected in recent levels of takeover activity. Q1 2023 saw high levels of UK plc takeover developments, including: 7digital, AdEPT Technology Group, Cenkos / finnCap (merger), Devro, Dignity, ECSC Group, Hyve, Hurricane Energy, Kape Technologies, Purplebricks, Seraphine, Unbound and Wood Group.

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 Trust’s NAV Total Return increased by 7.6% over the quarter, outperforming the FTSE Small Cap Index (excluding Investment Companies)² which decreased by 1.6% and beating the UK Smaller Companies Investment Trust sector which decreased by 0.6%.

Key contributors to returns in the quarter to 31 March 2023, came from: **XPS Pension Group** (+17%), following a trading update in which revenue exceeded market expectations, with continued high levels of client engagement around advisory services following the LDI developments in late 2022; **Inspired** (+50%),

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

following FY22 results that demonstrated healthy cash generation and progress in cross-sell, in addition to strong Q1 2023 momentum and FY23 outlook; and **Medica Group** (+11%) following healthy FY22 results, which confirmed that previously announced capacity constraints had been temporary and subsequently alleviated.

The main detractors in the period were: **Brooks Macdonald** (-11%), following negative share price sentiment due to several senior management departures, which the Manager believes to be coincidental and inconsequential to the investment thesis; **Tribal Group** (-15%), following a profit downgrade due to the termination of its contract with NTU Singapore; and **Fintel** (-6%), which delivered FY22 results in line with market expectations albeit with some minor EPS underperformance.

Portfolio activity

The Trust made two new investments in the period; into **Carr's Group**, an international provider of agricultural nutrition products and nuclear engineering solutions, with attractive end-market tailwinds and a new management team with strong track records of UK plc value creation; and in to **Netcall**, a leading provider of Customer Engagement and Intelligent Automation software, with significant levels of recurring revenue and organic growth, and attractive demand dynamics for cloud-based services.

The Trust also made two full exits in the period: **AssetCo**, which was held following its all-share takeover of River & Mercantile last year, but which did not fit the long-term investment criteria for the Trust; and **Nexus Infrastructure**, which divested its TriConnex and eSmart divisions and whose remaining business in isolation did not fit the investment criteria for the Trust.

Outlook

We continue to expect that market conditions will remain volatile throughout 2023, despite early signs of positive economic developments. However, the Trust remains well positioned, 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.

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.

As already supported by announcements during the first couple of months of the year, we expect to see a resurgence of takeover activity amongst listed UK companies as 2023 progresses, as corporate and private equity buyers seek to benefit from ongoing dislocation between strong company fundamentals and UK equity valuations. Significant levels of capital yet to be deployed by private equity firms, combined with the easing of longer-term interest rates, could continue to provide a supportive landscape for elevated corporate activity over the short-medium term.

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