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Strategic Equity Capital plc

Factsheet commentary – Q4 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. Views expressed by the investment team are correct at the time of writing but are subject to change.

Overview

Following a mixed Q3 2023 in which markets balanced the impact of disinflationary trends and positive GDP revisions, against weaker Purchasing Managers Index (PMI) and consumer spending data and an additional base rate hike, Q4 began with renewed unease over global geopolitical developments. However, continued signs of moderating inflation bolstered expectations for interest rate cuts in 2024, which supported a broad market recovery in the latter half of the quarter. Despite this, UK equity outflows continued to constrain valuations, particularly across the small cap universe.

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. We also continue to avoid investing in companies and sectors that we believe are disproportionately exposed to macroeconomic cycles and other exogeneous factors, for example banks, oil & gas and mineral companies.

Newsflow 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. Q4 2023 continued the year to date trend with a high cadence of takeover announcements across the UK small and mid-cap market.

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 4.3% over the quarter, underperforming the FTSE Small Cap Index (excluding Investment Companies)[2] which increased by 6.5% and moderately lagging the UK Smaller Companies Investment Trust sector which increased by 4.6%. However, this should be viewed in the context of material outperformance in prior quarters and for calendar year 2023 overall.[3]

Key contributors to returns in the quarter to 31 December 2023 came from: **XPS Pensions Group** (+19.5%), which in addition to strong interim results and upgrades announced that it has been appointed to provide pension administration services for the John Lewis Partnership, the UK's largest employee-owned business; **Fintel** (+33.6%), following a number of strategic acquisitions which will significantly increase the

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
3. Full performance history can be viewed in the associated factsheet

capabilities, scale and breadth of the organisation; and **Brooks MacDonald** (+17.1), on results which demonstrated positive trends in underlying fund flows despite market headwinds and announced a cost efficiency initiative to improve margin.

The main detractors in the period were: **Randall & Quilter** (-82.1%), following the proposed sale of the company's Program Management business at a valuation significantly below market expectations; and **Trufin** (-21.3%), following interim results indicating some delays to anticipated contracts as well as the disposal of subsidiary Vertus.

Portfolio activity

The Trust made three new investments during the quarter; into **Team17,** an independent video game developer and publisher which is well known to us. Following an unexpected profit warning in November and subsequent review, we believe the long-term fundamentals of the business remain strong and that the current reduced share price offers an attractive opportunity to establish a position in the Trust; **Belvoir Group,** and **The Property Franchise Group,** the two leading UK residential franchised estate agencies which are similarly well known to us. Both businesses are capital light, highly cash generative and predominantly exposed to the resilient and structurally growing UK residential lettings market.

The Trust made no full exits during the quarter.

Outlook

While global markets price in expectations of easing inflation and falling interest rates in 2024, we do not expect market volatility to abate given the ongoing macroeconomic and geopolitical uncertainty. We believe that present conditions will continue to generate mispricing opportunities across the UK market, particularly across the smaller companies segment, yet we are conscious to retain a sharp focus on resilient businesses with high-quality fundamentals.

The UK markets de-rated through 2023, with many companies continuing to trade at a stark discount to history, as well as versus international and private peers. As market valuations remain low it is worth considering that in in some cases de-ratings may be warranted. Through 2023 we saw elevated profit warnings across the UK market, a trend which we expect to continue into 2024, therefore some companies may not be as attractively valued as they initially seem and hence, we view this as a stock-pickers market. We continue to leverage our network to glean unique expertise and analytical insights, helping us validate and build conviction across discrete components of our investment theses. Using this advantage in tough market conditions navigates us away from 'value traps' which tend to appear in a 'cheap' market, allowing us to focus our deployment into high quality businesses, trading at attractive valuations.

We also expect M&A activity to persist into early 2024 as UK equities remain heavily discounted relative to comparable M&A transactions. In the US and Europe, mid-to-large leveraged buyout firms are looking to offset the higher cost of debt by purchasing UK listed businesses at steep discounts to intrinsic value. The evidence from 2023 suggests that the private equity gaze is firmly fixed on UK smaller companies, where the discrepancy between trading multiples and company fundamentals appears most prevalent. As the M&A activity continues, we cautiously expect investors to bridge the gap between stock market valuations and UK company fundamentals.

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