

WS Gresham House UK Multi Cap Income Fund

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

Overview – Q4 2023

UK equity markets entered Q4 2023 with the Bank of England base rate at 5.25%, the highest level in 15 years. While surprise disinflation and base rate stability provided positive signals, market performance in September was broadly flat. In October, UK stock market indices declined as emergent geopolitical instability in the Middle East intensified global uncertainty. This theme persisted throughout the quarter, most recently as attacks on commercial ships in the Red Sea pushed freight costs higher. However, continued reductions in headline inflation and stable base rates supported a rebound in UK equity performance during November and December; the FTSE 350 rallied by 7.0% and the FTSE AIM All Share Index by 12.3%, with markets pricing in expectations of continued moderating inflation and falling interest rates in 2024.

During this volatile period M&A activity across the UK market remained elevated, especially at the smaller end of the market-cap spectrum, further evidencing the steep valuation discount currently applied to UK smaller companies versus comparable M&A transactions.

We operate under the assumption that the economic and geopolitical uncertainties which characterised Q4 2023 will continue to drive periods of market volatility. Nevertheless, we are confident in the strong fundamentals of our portfolio companies and their ability to navigate external headwinds. Particularly, we focus on businesses with quality management teams who pursue clear growth strategies in structurally growing markets and those which benefit from strong competitive positions and robust financial profiles. As a result, we think our portfolio companies can continue to grow earnings, generate attractive cash flows, and pay sustainable and growing dividends throughout the cycle.

Newsflow across the portfolio was largely positive in Q4 2023, as several companies delivered positive trading updates or made acquisitions which were well-received by the market. As an indicator of portfolio quality and resilience, c.90% of company updates in the fund have been in-line or positive relative to market expectations during 2023.

Performance¹

Performance in the WS Gresham House UK Multi Cap Income Fund increased by 6.7% during the month, outperforming the IA UK Equity Income sector which increased by 4.9% and the FTSE All-Share Index

1. Please refer to the factsheet for full UCITS-compliant performance figures.

2. The IA UK Equity Income sector and FTSE All-Share Index comparator are used for illustrative purposes only.

which increased by 4.4%.²

Key positive contributions came from **Smart Metering Systems (+47%)**, following a recommended cash offer from US private equity group KKR, at a 40% premium to prior day close; **Ten Entertainment (+35%)** following a recommended cash offer from Trive Capital at a 33% premium to prior day close; and **Integrafin (+17%)** following year-end results materially above market expectations characterised by record funds under management (FUM) and strong net inflows driven by the Transact platform.

The largest detractors to performance were **XPS Pensions Group (-3%)** on no specific news; and **B&M (-3%)**, following a large sale of stock by founder and large shareholder, Simon Arora, who since committed to a 180-day lock-up period for his remaining stake.

Portfolio activity

We made one new investment during the period, into **Mears Group**, a maintenance service provider to the affordable housing sector in the UK. We believe that risk to market earnings expectations is weighted favourably to the upside given positive bidding momentum for new contracts and strong demand for accommodation services.

We made several, selective follow-on investments during the period including **Halfords**, as we believe the current rating fails to reflect the recent strategic progress made in repositioning the business towards services versus retail, nor the significant self-help levers that are delivering cost savings; **Intermediate Capital Group**, as we have conviction in the potential for continued asset and management fee growth driven by strong performance across private credit and strategic equity strategies; and **Telecom Plus**, as we see strong customer growth and increased multi-service penetration as underpinned by a unique partner selling model, creating shareholder value over the medium-to-longer term.

There were no full exits during the period.

Outlook – Q1 2024

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 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 and sustainable income characteristics.

The UK markets de-rated through 2023, with many companies continuing to trade at a stark discount to history, fundamentals as well as versus international and private peers. As market valuations remain low it is worth considering that 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 prevalently. As the M&A activity continues, we cautiously expect investors to bridge the gap between stock market valuations and UK company fundamentals.

Another dynamic in the UK equity market which we consider supportive of fund performance over the coming months is the elevated level of buyback activity. These shareholder distributions are not occurring at the expense of investment in growth; rather we are seeing our portfolio companies return surplus capital to shareholders by buying back shares at cheap valuations. These buybacks have initiated a form of reverse compounding whereby share counts reduce, dividends per share increase, and dividend yields expand. As long as UK management teams continue to deem valuations materially lower than their estimates of intrinsic value, we expect this dynamic to keep delivering shareholder returns in 2024.

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