Gresham House
Specialist investment

WS Gresham House UK Micro Cap Fund

Quarterly commentary – Q3 2026

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 – Q3 2026

UK equity market performance was positive in the third quarter of 2026 as smaller company stocks generally outperformed their larger peers. The Deutsche Numis Smaller Companies plus AIM ex-Investment Trusts Index, FTSE AIM All Share, and FTSE 250 Index rose by 8.0%, 2.5% and 7.4% respectively, while the FTSE 100 Index rose by 1.8% in comparison.

The defining feature of the quarter for UK domestic assets was fiscal politics. Andy Burnham became Prime Minister in July, with John Healey succeeding Rachel Reeves as Chancellor, and the new administration's first Budget being set for 28 October. With rises in the headline rates of income tax, employee National Insurance and VAT ruled out, speculation has centered on capital gains, dividend and pension taxation, the areas that matter most to domestic investors in UK equities. As in previous years, this has created an extended period of uncertainty and speculation in which business and stock market activity is paused or delayed, and we expect it to weigh on domestic flows until the Budget.

UK-focused equity funds saw net outflows of £601 million in August and a further £708 million in September[1], with Calastone attributing much of the caution directly to continued Budget speculation. Across all equity funds, UK investors have now withdrawn £5.5 billion since the start of the year, with bond and money market funds absorbing £3.5 billion of that capital over the same period[2]. This is a sentiment-driven sell-off, as the selling has been concentrated in domestic mandates at a point when portfolio company earnings have been resilient. The same dynamic preceded the 2024 and 2025 Budgets, and in each case the removal of uncertainty, rather than the content of the Budget itself, proved the more powerful driver of subsequent flows.

The interest rate backdrop also shifted materially during the quarter, contrary to market expectations at the start of the year. Protracted conflict in the Middle East has kept crude and refined energy prices elevated and volatile, pushing UK CPI inflation to 3.1% in August, with the Bank of England now expecting inflation to reach slightly above 4% in the first quarter of 2027. The Monetary Policy Committee held Bank Rate at 3.75% on 17 September, but the 6-3 vote, with three members preferring an immediate increase to 4%, and the accompanying guidance have led markets to begin pricing in a rate increase. Gilt yields have risen accordingly, with ten-year yields reaching levels not seen since before the global financial crisis and thirty-year yields at their highest since the late 1990s, alongside a broader global bond sell-off following the US Federal Reserve's first increase in three years. Higher discount rates are an unhelpful backdrop for small and mid-cap valuations in the short term, though the underlying businesses we own, which carry low or no financial leverage, are far more insulated from higher borrowing costs.

Software and data businesses were among the hardest hit by the AI-driven sell-off in the first quarter, as the

[1] Calastone Fund Flow Index 07 October 2026
[2] Calastone Fund Flow Index 07 October 2026

market priced disruption risk indiscriminately across the sector. Six months on, our software and platform holdings have delivered growing recurring revenue, stable or improving customer retention and AI-led product demand, yet share prices have only partially recovered and the valuation discount of UK-listed software to US peers has widened from 76% to 84%. M&A activity in the sector has since restarted, with Pinewood Technologies, Eleco and Tribal Group all receiving bids. At Tribal, Main Capital Partners increased its recommended cash offer from 86p to 105p per share (a premium of 67% to the undisturbed price), before existing major shareholder Jenzabar announced a possible counter bid of 111p per share (a premium of 73% to the undisturbed price). This shows buyers are paying premiums for platforms with proprietary data, entrenched workflows, high switching costs and system-of-record status in complex, regulated markets. These are the characteristics we identified in our own relevant holdings earlier in the year, and where we added to positions at depressed valuations. We continue to see selective opportunity in well-protected businesses that can use AI tools as a source of operating leverage rather than be displaced by them.

Announced bids for UK-listed companies reached approximately £40 billion across 18 deals during the third quarter, taking the year-to-date total to around £76 billion, already more than double the £29 billion recorded across the whole of 2025[3]. Activity spanned the market capitalisation spectrum and was dominated by overseas buyers, who accounted for around three-quarters of third-quarter deal value. At the larger end, Prologis' £13.5 billion offer for Segro and the £5.7 billion offer for DCC from KKR and Energy Capital Partners were joined by private equity approaches for easyJet, Mitie and Bodycote, while further down the market Gooch & Housego and Gamma Communications both received bids. Set against just £577 million raised from UK IPOs in the first half of 2026[4], the UK market continues to shrink. However, ongoing M&A activity highlights quality, undervalued businesses that financial and trade buyers globally want to own at significant premiums. We believe the valuation dislocation presents a highly attractive set of investment opportunities.

We believe our high-conviction stock selection and portfolio management style provides investors with a source of potential outperformance driven by earnings growth, cash generation and organic re-rating. Our focus is on businesses with strong fundamentals such as structural market drivers, solid and defensible market positions, high-quality earnings streams including recurring revenues, high margins, resilient balance sheets, and capable and aligned management teams. These fundamentals translated into resilient operational delivery during the period, with 100% of trading updates or financial results across the portfolio either positive or in line with market expectations.

Performance – Q3 2026

Performance in the WS Gresham House UK Micro Cap Fund increased by **7.7%** during the quarter, outperforming the IA UK Smaller Companies sector which increased by **6.7%**.

Key positive contributions came from **Tribal (+3.6% Contribution to Total Return ("CTR")),** as Main Capital Partners signed an acquisition agreement for Tribal's operating subsidiaries at a valuation equivalent to 105p per share (a premium of 67% to the undisturbed price) following an initial agreement at 86p per share, before existing major shareholder Jenzabar announced a possible counter bid of 111p per share (a premium of 73% to the undisturbed price); **SysGroup (+1.8% CTR),** following full-year results confirming a turnaround in performance, with adjusted EBITDA up 26% ahead of expectations and management now guiding FY27 to exceed market expectations; and **Diaceutics (+1.2% CTR),** following interim results which showed revenue growth of 22% and annual recurring revenue growth of 79% to £29.4m, with the contracted order book up 38% providing 107% visibility on full-year revenue.

The largest detractors were: **ActiveOps (-1.3% CTR),** despite strong full-year results reporting solid revenue

[3] Bloomberg 30 September 2026

[4] EY-Parthenon, IPO Eye Q2 2026, 07 July 2026

and adjusted EBITDA; **Molecule Group (previously called Vulcan Two Group) (-1.2% CTR),** on no specific company news flow during the period; and **Pulsar Group (-1.2% CTR**), following confirmation that the Group had settled an unexpected outstanding tax liability with HMRC, resolving a situation first disclosed in August, despite management describing underlying trading as robust with notable contract wins across all regions.

Portfolio activity

The Fund made two new investments during the period, into: **Avingtrans**, a specialist engineering group supplying mission-critical components and services to the energy, medical and industrial sectors, which we believe is well positioned to benefit from structural growth in clean energy, defence and healthcare markets, with recent trading updates highlighting record order intake, continued margin improvement and the successful integration of recent acquisitions; and **Dotdigital**, which provides AI-powered software that helps businesses automate their marketing and engage with customers. Its subscription model is highly scalable and delivers recurring revenues. Recent progress - including strong interim results and the acquisition of Social Snowball - demonstrates continued product innovation and customer growth. The shares trade at around 6x EV/EBITDA (including deferred consideration), a valuation we believe is attractive for a business of this quality.

The Fund made two full exits during the period, from: **Staffline**, following full-year results and a trading update which demonstrated continued operational momentum and a strong start to 2026. With the turnaround strategy increasingly reflected in the valuation we took the decision to redeploy capital into higher-conviction opportunities with greater return potential; and **Franchise Brands**, following strong interim results which highlighted record system sales across its core B2B businesses, continued deleveraging and an increase in the interim dividend, which we viewed as a good opportunity to realise value.

Outlook – Q4 2026

Despite geopolitical tensions, market volatility, the threat of AI disruption, rising interest rates and political uncertainty ahead of the Budget, we remain confident in our well-constructed portfolio. This ongoing uncertainty is creating a volatile backdrop, but one that is presenting a large opportunity set for active, fundamentals-led investors. Our companies share strong long-term fundamental characteristics: earnings growth with high visibility of revenues in less cyclical segments of the economy; attractive margins reflecting solid market positions; low or no financial leverage providing resilience in an uncertain macro environment; good cash generation underpinning financial returns; capable and agile management teams aligned with creating long-term shareholder value. Operational delivery across the portfolio also remains strong, with a high hit rate of trading updates and results in line with or ahead of expectations. In our view these are companies that should command premium ratings on the public markets. Instead, many trade at historically low valuations, a dislocation between fundamentals and valuations that continues to be exacerbated by the ongoing outflow dynamic from UK domestic equity funds. If the market fails to rate these businesses appropriately then it is likely we will continue to see an elevated level of takeover approaches for businesses where private equity and strategic buyers appreciate the value on offer. Notably, M&A activity at the mid and large cap end has escalated markedly this quarter, underlining that this is no longer a dynamic confined to smaller, under-the-radar companies.

Looking into the fourth quarter and beyond, we would highlight the following:

- The valuation gap between large and smaller companies remains historically wide, leaving significant room for smaller companies to re-rate as investors seek relative value

- Interest rates may now rise rather than fall, but our companies' low or no financial leverage leaves them well placed to absorb higher borrowing costs
- Greater clarity following the 28 October Budget should help ease the uncertainty that has weighed on UK markets
- Takeover activity, already more than double 2025's total, highlights the value global buyers see in quality UK businesses. While new listings are not yet replacing what is being acquired, there are early signs of the IPO market reopening
- Small caps often lag early in a recovery, but history shows that when they turn, they can rebound quickly and sharply, a key driver of their long-term outperformance

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