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Gresham House
Specialist asset management

LF Gresham House UK Micro Cap Fund

Factsheet Commentary - October 2021

Overview

October continued the themes of the previous month with an increasing level of market volatility driven by heightened supply chain shortages across the UK and ongoing negative sentiment surrounding inflationary pressures, among other things. This was juxtaposed with a continued elevated level of equity issuance including a number of further smaller company IPOs, although the period also saw a number of deals being withdrawn due to weaker demand and greater scrutiny over valuations.

Despite the increasing volatility and moderating sentiment, we continue to believe that the longer-term opportunity in UK Smaller Companies is underpinned by the continuing discounted valuations applied to the UK and to UK Smaller Companies, in particular, which remains material. This is still the case despite the strong market performance since Q4 2020. We also expect the elevated level of takeover activity to continue in coming months while this discount remains intact.

The current dynamic market environment continues to offer a number of investment opportunities. We remain selective and disciplined in our approach, seeking high quality companies with attractive long-term capital growth characteristics at sensible valuations.

Performance

The Fund delivered a return of -1.14% during the month, modestly outperforming the IA UK Smaller Companies sector which decreased by -1.87% and modestly underperforming the NSCI + AIM (ex IC) index which decreased by -0.61%.

Key contributions to returns came from **TruFin** (+34%) after the Fund participated in a secondary placing of a major legacy shareholder’s stake at a material discount to the prevailing share price prior to the transaction; **Angling** (+13%); and **Elixirr** (+8%) both following positive results statements.

The largest detractors to performance were **Gym Group** (-12%) which de-rated on no specific news; **Inspired** (-11%) which de-rated on market sentiment around the potential near term impact of the UK energy crisis; and **Accrol Group** (-17%) which fell on the back of a trading update highlighting the short-term impact of supply chain disruption on input costs.

Portfolio activity

During the period we made one material new investment into **Tortilla Mexican Grill**, a fast casual dining and takeaway food chain, as part of its AIM IPO. The Fund made follow-on investments into **Angling Direct, Randall & Quilter**, and **Seraphine Group** taking advantage of market volatility to top up positions. The Fund also added to its position in **Kape Technologies** as part of a placing of new equity to fund an acquisition as well as participating in the previously mentioned secondary placing in **TruFin**.

There were two full exits: **Mortgage Advice Bureau** (+143%) a long-standing holding which had performed well and where the Manager decided to take profits and reinvest in other opportunities with more attractive long-term returns prospects; and **GetBusy** (+37%) a smaller holding that had performed strongly and was sold on valuation grounds. The Fund also top sliced its position in **Instem** (+64%) to take profits after a strong share price performance since the original investment.

Outlook

Our medium-term view remains that the economic recovery in the UK should continue to support earnings growth and share prices. However, we continue to expect volatility in the short term driven by an inherently uncertain environment for market estimates. We are now seeing aftershocks from the pandemic such as the currently elevated level of inflation across a number of areas and both global and domestic supply chain disruption impacting at the company level. We also anticipate a rising number of profit warnings in coming months. This in turn is likely to exacerbate share price volatility for individual stocks.

We believe stock level volatility across the market, while creating some challenges, will provide an attractive environment in which we can unearth good long-term investment opportunities at attractive valuations. The economic environment and lingering COVID-19 discontinuity will provide agile smaller businesses with strong management teams with the opportunity to take market share and build strong long-term franchises.

We continue to believe that our fundamental focused investment style has the potential to outperform over the long term. The Fund will maintain its focus on building a high conviction portfolio of less cyclical, high quality, niche growth businesses which we believe can deliver strong returns through the market cycle regardless of the performance of the wider economy.