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LF Gresham House UK Smaller Companies Fund

Factsheet Commentary - December 2021

Overview

December continued recent themes, with an increasing level of market volatility driven by heightened supply chain shortages across the UK and ongoing negative sentiment surrounding inflationary pressures and continued fears over the Omicron variant. Despite this backdrop, equity issuance remained relatively active, with a few smaller companies issuing new equity, and some IPO activity continuing, although at a more moderate level than earlier in the year.

Despite the increased volatility and weaker 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 smaller companies, in particular, which remains material. We believe this situation is supportive of finding attractive investment opportunities and should provide some downside protection to the UK market in the event of macroeconomic or geopolitical shocks.

The 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 LF Gresham House UK Smaller Companies Fund (the Fund) delivered a return of 6.4% during the month, compared to the IA UK Smaller Companies sector which increased by 4.6% and the NSCI + AIM (ex IC) index which increased by 4.5%.

Key contributions came from **Clinigen Group** (+64%), on news of a takeover agreement for the company by funds managed by Triton Partners, a private equity firm; **Alpha Financial Markets Consulting** (+19%), after announcing a positive trading update and continued momentum; and **Kape Technologies** (+13%), on no specific news.

The largest detractors to performance were **Accrol** (-7%), on the announcement of a delay in reporting half-year trading results and ongoing supply chain impacts; **River & Mercantile** (-6%), as the two potential acquirers had their put up or shut up deadlines extended by the Takeover Panel; and **Devro** (-4%), on no specific news.

Portfolio activity

The Fund made three new investments into **Telecom Plus,** a value multi-utility and telecoms service provider; **FRP Advisory;** an insolvency practitioner whose market opportunity is increasing as government support during the pandemic is withdrawn and **Halfords Group;** a retailer of motoring and cycling products and services that is executing a strategy to improve its earnings quality which we believe is not reflected in the current valuation. The Fund also made a number of follow-on investments into existing portfolio holdings, including **Flowtech, Balfour Beatty**, and **Alpha FMC** amongst others.

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 and the trajectory of central bank policy. We are still 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 the opportunity to take market share and build strong long-term franchises.

We continue to believe that our fundamentals-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.

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