

Strategic Equity Capital plc

Factsheet commentary – Q2 2022

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.

Overview

The quarter was dominated by market volatility driven by negative sentiment surrounding inflationary pressures, expectations of ongoing interest rate rises, and an impending cost of living squeeze in the UK – all of which weighed on UK equities. Russia's invasion of Ukraine has resulted in an ongoing broader correction across global equity markets, being particularly pronounced in UK and European equities. In addition, Calastone data¹ showed continued material outflows from UK equity funds adding to the pressure on share prices.

We have been anticipating increasing market and stock level volatility for some time and believe our portfolio is set up to deliver long-term resilient value with growth opportunities. This is due to our rigorous investment process focusing on high quality fundamentals-based businesses that are relatively insulated from wider macro factors and are trading at reasonable valuations.

Despite the increased volatility and weaker sentiment, we continue to believe that the longer-term opportunity in UK small cap equities remains material. This is underpinned by the continuing discounted valuations applied both to the overall UK equity market and, in particular, to the smaller companies segment, providing some downside protection in more challenging market conditions.

Notwithstanding the fast-moving geopolitical situation, we believe market conditions are increasingly supportive of finding attractive investment opportunities for those prepared to take a longer-term view. We remain selective and disciplined in our approach, seeking high-quality companies with attractive long-term sustainable income and capital growth characteristics at sensible valuations.

Performance²

The Fund NAV Total Return decreased by 5.7% over the quarter, outperforming the FTSE Small Cap Index (excluding Investment Companies) which decreased by 10.5% and the UK Smaller Companies Investment Trust sector which declined by 12.5%. We believe the outperformance is notable given the Fund's lack of exposure (by design) to the more cyclical sectors which, by and large drove the market during the period.

Key contributors to returns in the quarter to 30 June 2022, came from: Hostelworld (+21%), an online travel agent demonstrating recovering demand driven by the easing of global travel restrictions; XPS Pensions Group (+5%), an actuarial consultancy; and Iomart (+7%), a computing and IT managed services business, both of which reported strong full year results.

The main detractors in the period were: Tyman (-23%), a building products supplier, which de rated on concerns about exposure to inflation and supply chain risks despite announcing a trading update in line with market expectations and having mitigated these issues during the period; Ten Entertainment Group (-22%), a ten-pin bowling operator due to deteriorating sentiment around the UK consumer spending outlook; and Brooks Macdonald Group (-15%), an investment management services provider, due to exposure to weakening equity markets.

1. Gresham House takes no responsibility for third party data

2. Where holdings' returns are stated, please note these are Total Returns, including dividends, for each of those stocks over the quarter

Portfolio activity

The Fund made one new investment, into Randall & Quilter, a niche insurance services provider, and a follow-on investment into Inspired where the Fund alongside other Gresham House managed funds remains the largest shareholder with an increased 29.7% equity stake.

Realisations totalled £16.7mn in the quarter. This included full exits for Clinigen (19% IRR), following the completion of its takeover by Triton; and River & Mercantile (37% IRR), following its takeover by AssetCo; as well as partial sales of Wilmington.

Outlook

Aftershocks from the pandemic that emerged towards the end of last year, such as elevated inflation across a number of areas and global and domestic supply chain disruption, have been exacerbated by the Russia / Ukraine crisis. This has caused acute dislocations in asset classes globally and deteriorating equity market sentiment so far during 2022.

Taken in aggregate we believe this is an attractive environment to invest. Whilst ongoing uncertainty can be challenging, it also provides the opportunity to unearth good long-term investments at attractive valuations. At a portfolio level, we have limited exposure to companies that are directly impacted by the issues noted; a direct output of our highly selective, quality-focused investment approach. Second and third order effects – of both the pandemic, and of an inflationary and uncertain geopolitical environment – can be difficult to predict. However, we believe agile smaller businesses with strong management teams will have the opportunity to take market share and build strong long-term franchises.

The elevated levels of corporate activity within the UK equity space continue to play out. We believe our investment process and private equity lens across public markets position us well to identify investment opportunities with potential strategic value that could be attractive acquisitions for both corporate and financial buyers.

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.

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