

WS Gresham House UK Multi Cap Income Fund

Quarterly commentary – Q1 2025

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 – Q1 2025

UK equity market performance was mixed in the first quarter of 2025 as smaller company stocks generally underperformed their larger peers. The Deutsche Numis Smaller Companies plus AIM ex-Investment Trusts Index, FTSE AIM All Share, and FTSE 250 Index declined by **5.9%**, **4.9%** and **5.0%** respectively. In contrast, the FTSE 100 Index rose by **6.1%**.

During the quarter, several dynamics negatively impacted on the performance of the UK smaller companies sector, however we have observed strong fundamental business performance across the portfolio. There were 43 company trading updates or results announcements during the period, of which 84% were in-line with or ahead of market expectations (37% ahead). Based on the degree of positive earnings upgrades across the portfolio, we would have expected low single-digit aggregate Fund performance had valuations remained static during the period.¹ In reality, a broad de-rating across the portfolio more than offset positive fundamental progress in terms of earnings growth, cash generation, and dividends.

A variety of factors have contributed to this de-rating in our view. Domestically, the national insurance (NIC) and minimum wage changes announced in the government's Autumn Budget have continued to reverberate across the UK economy as consumers and companies prepared for implementation of new measures. We have seen a sharp and relatively broad-based slowdown in consumer footfall, particularly concentrated among low-earning consumers, as uncertainty regarding the employment outlook in that cohort has driven lower spending. While the majority of portfolio companies were insulated from these adverse dynamics, UK consumer and business sentiment has weakened since the Autumn Budget, driving risk-off investor attitudes towards UK smaller companies. Moreover, the change in government policy towards inheritance tax relief available on AIM-listed equity investments has caused a handful of larger AIM-listed companies to seek main market listings, leaving an overhang of inheritance tax (IHT)-focused investors who are expected to become forced sellers in the short term, albeit we expect to see those IHT funds redeployed into other AIM companies in due course.

UK equity markets also remain out of favour compared to other international markets. The first two months of 2025 saw accelerating outflows from UK-focused equity funds of £1.1bn and £1.2bn respectively, with most of the money rotating into US or global equity funds. Net outflows have exerted downward pressure on UK smaller company valuations across the board, and we believe the subsequent de-rating explains the negative performance given in-line and positive earnings revisions on aggregate during the period. Moreover, the initial rhetoric and policies of the new US administration has fueled geopolitical and

¹ Weighted average (using daily average NAV) earnings growth based on forecast earnings per share at the start and end of the period.

macroeconomic uncertainty, causing multiple developed equity markets to sell off, particularly in anticipation of widespread trade tariffs.

Evidently, domestic and global circumstances are currently headwinds to equity market performance generally. Nevertheless, we take comfort from the strong operating performances and outlooks of our portfolio companies, whose earnings profiles and value creation potential are largely insulated from external factors.

Our bias towards defensive fundamental characteristics such as structural growth drivers, high margins, and strong cash generation to support progressive dividends has led to a high proportion of companies delivering results in-line with or ahead of market expectations. We continue to see the dislocation between portfolio company fundamentals and valuations – which has widened during the quarter – as a compelling medium-term opportunity.

Performance – Q1 2025

Performance in the WS Gresham House UK Multi Cap Income Fund decreased by **5.9%** during the quarter, underperforming the IA UK Equity Income sector which increased by **1.2%**.

Key positive contributions over the period came from: **Gresham House Energy Storage Fund (+0.6% CTR)** as two trading updates during the period showed a material improvement in the merchant revenue environment while a firm all-cash offer by Drax for a major listed competitor, Harmony Energy Income Trust, valued the business at close to parity with net asset value on a megawatt and megawatt-per-hour basis; **XPS Pensions Group (+0.4% CTR)** following a full-year trading update which disclosed continued strong demand for pensions advisory services and earnings materially ahead of market expectations; and **Schroders (+0.4% CTR)** following full-year results ahead of expectations due to a lower rate of institutional outflows than expected in the fourth quarter, combined with a positive earnings outlook underpinned by the announcement of a £150mn three-year cost savings programme which aims to increase operating margin from c.25% to 30%.

The largest detractors to performance were: **Ricardo (-1.3% CTR)** following a significant profit warning in late January driven by order delays in the high-value Energy and Environment segment as well as Rail, however, we have extensively engaged with the management team and board on a value recovery plan; **Greggs (-1.1% CTR)** following full-year results in-line with expectations, offset by near-term like-for-like trading weakness attributable to lower footfall amidst negative shifts in consumer confidence and economic uncertainty as well as 250 store closures in January due to weather warnings; and **B&M (-0.9% CTR)** following a 3% downgrade to Full Year 2025 EBITDA expectations given weaker like-for-like growth rates than expected in the fourth quarter, primarily driven by the FMCG segment, as well as the unexpected departure of the CEO. Again, we have engaged with the management team and Board, and believe the long-term value prospects and business model are intact.

Portfolio activity

We made no new investments during the period.

We made two full exits during the period from: **Argentex**, which while we continue to believe offers attractive long-term value driven by structural market tailwinds, an attractive platform-based proposition to drive share gains, and an attractive financial profile, the investment had become sub-scale within the portfolio. Given the small market capitalisation of the company and lower liquidity profile, Argentex was not sufficiently aligned with this portfolio's strategy to justify building a position with a higher weighting of net asset value; and **Impax Asset Management**, following a fundamental shift in our investment thesis, primarily focused on our negative outlook on the long-term flow prospects of the key BNP Paribas distribution channel.

We made several selective follow-on investments during the period, including into: **Inspired**, a tech-enabled energy & ESG services provider which benefits from structural demand tailwinds for energy procurement optimisation and other ESG solutions and quality financial characteristics. We participated as part of an equity placing which re-capitalised the company following short-term contract delays which have now completed; **Nichols**, the global brand owner of Vimto soft drinks, which we believe is well positioned to take share in a structurally growing UK squash market and benefits from a diversified and primarily outsourced business model, generating a high return on invested capital and strong free cash flow to support progressive income growth; and **Brooks Macdonald**, an investment management services provider, which we view as a leading player in the highly fragmented wealth management sector and as materially undervalued relative to precedent M&A transactions in the space.

Outlook – Q2 2025

Looking ahead to Q2, we remain cautious about the short-term macroeconomic and geopolitical outlook given current headwinds, however, our portfolio companies have demonstrated good operational resilience with the majority announcing constructive earnings outlooks in this challenging environment.

While we expect US tariffs and the retaliatory actions of its trading partners to have an influence on the global economy and equity markets during the next quarter, we believe the strong fundamental performance of our portfolio companies reflects our emphasis on defensive, idiosyncratic characteristics, which better insulate overall Fund performance from external headwinds. Circa 74% of equity net asset value is invested in services-focused businesses, while on average, 78% of portfolio company revenues are derived from the domestic UK economy,² protecting investee companies from direct tariff pressure. More importantly, we believe these companies benefit from strong positions in structurally growing end markets and quality financial characteristics including very low financial leverage, high margins, and a high return on capital. These high-quality businesses are managed by capable, experienced, and aligned management teams exercising value creation levers in their direct control. Indeed, recent events highlight the advantages of avoiding sectors in which key investment drivers are beyond management influence.

Over the medium term, we retain conviction that our portfolio companies can consistently drive earnings growth, cash generation and dividends, with optionality for selective re-rating as the market gradually reflects positive fundamental progress and prospects in valuations. We therefore see the current dislocation between portfolio company fundamentals and valuations – which has widened since year-end – as a compelling long-term buying opportunity.

While uncertainty has persisted into this year, we see upside potential to Fund performance from elevated takeover activity across UK equity markets. In the first quarter, there was an increase in activity as expected, with 15 companies with a market capitalisation of over £100 million entering bid situations at an average premium of 36% versus the undisturbed prior-day price.³ Corporate and financial buyers are attracted to the discounted valuations available in UK equity markets which do not properly reflect the strategic value or high-quality fundamental characteristics on offer. Ultimately, this bid activity should illustrate the discounted nature of comparable businesses in relevant sectors and demonstrate scope for organic re-rating over time.

We have also seen greenshoots of IPO activity over the first quarter of 2025, with some of the businesses considering or actively pursuing listings being of considerable scale compared to those of the last two years. In this light, we continue to press for government reforms which offer structural support to UK capital markets, both in terms of alleviating downward valuation pressure and preventing ongoing de-equitisation. Part of the solution lies in promoting greater UK pension fund participation in domestic equity markets, where they are materially under-penetrated today at defined contribution, defined benefits, and local government levels compared to other developed western nations.⁴ Should the UK pensions sector increase investment in domestic equities in-line with developed peers, this additional liquidity would help alleviate the valuation issue we describe, revitalise UK capital markets as an attractive listing venue for quality innovative businesses, and

² Weighted average by equity net asset value as of 31 March 2025

³ Charles Hall, 'Pace of M&A quickens', Peel Hunt, 1 April 2025

⁴ Department for Work & Pensions, 'Pension fund investment and the UK economy.'

promote greater investment in the wider UK economy.

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