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Economic Advantage

October 2023 review

Liontrust Special Situations Fund

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The Liontrust Special Situations Fund returned -4.7%* in October. The FTSE All-Share Index comparator benchmark returned -4.1% and the average return in the IA UK All Companies sector, also a comparator benchmark, was -5.1%.

The month saw a continuation of the themes that characterised the third quarter, with investors adjusting to the expectation of higher-for-longer interest rates and large-cap shares continuing their recent run of outperformance.

Events in Israel and the Gaza Strip dominated global news during the month. Although global equity markets retreated in October, there was otherwise only moderate evidence that the conflict was leading to typical flight-to-safety patterns in financial markets. Gold did rise 7% to $1983 an ounce, but oil (Brent crude) dropped 8% to $87.4 a barrel and government bond prices remained under pressure due to rising yields.

Within the UK market, the large-cap FTSE 100 Index fell 3.7%, while the FTSE 250 mid-cap Index dropped 6.3%, the FTSE Small Cap (ex investment trusts) Index slid 5.9% and the AIM All-Share lost 6.2%.

Portfolio newsflow was relatively light in October. **RWS Holdings** (-13%) commented in a trading update covering the year to 30 September that profits would be "within the range of market expectations", language that was seen as akin to a modest guidance downgrade by investors. The company cited an analyst range of £116.5m to £129.0m and consensus of £125.8m, suggesting a downgrade of up to 7.5%. The intellectual property support services group saw an organic revenue decline over the year, although this marginally improved from -7% in the first six months to -5% in the second half of the year. RWS cites the macroeconomic environment as responsible for end market weakness, but also notes that its shift into higher growth segments – such as AI-enabled solutions – should help combat this.

Evidence of some cyclical demand weakness also accounted for share price weakness at **Renishaw** (-12%). A trading update revealed the quarter to 30 September saw a 6% constant currency in revenues compared to last year's level, as all divisions experienced reduced demand. The specialist in high-tech precision measuring and calibration equipment stated that demand was subdued in a number of areas, notably the semiconductor sector, but there are more encouraging trends in robotics, defence and low emission transportation.

Having de-rated somewhat over the summer months, shares in **YouGov** (+13%) rallied after releasing a solid set of full-year results and issuing in-line guidance. The research data and analytics group grew revenues by 9% on an underlying basis in the year to 31 July, with adjusted operating profit rising 23%. The company notes that this growth came against a tough macroeconomic backdrop and is ahead of sector benchmarks. YouGov stated that trading in the new year has begun in line with expectations, giving it confidence in hitting the market's forecasts for the 2024 financial year.

The strength of the immediate 'relief bounce' in YouGov's share price on an 'in line' statement is testament to the level of pessimism still baked into share prices, particularly at the lower end of the market cap scale. Many businesses are clearly experiencing some degree of impact from broader macroeconomic pressures, but on the whole we feel that our companies are trading robustly, with around three quarters of the Fund's holdings announcing in-line results or even upgrading expectations. Despite this show of resilience, a large number of stocks are trading on very low valuation multiples, offering extremely rare levels of longer term upside opportunity. Over 40% of the Fund's holdings are currently trading on a leveraged buy-out (LBO) free cash flow yield of over 10%, according to data from Canaccord Genuity Quest – a level above which valuation is viewed as being notably attractive to a potential acquiror.

While it is easy to wonder whether the extremity of the valuation gap between UK stocks and those listed on other global markets will persist in perpetuity, the Economic Advantage team are increasingly optimistic that there are several catalysts which may yet turn the tide strongly in favour of UK equities.

One is M&A activity. 14 companies across the Economic Advantage fund range have experienced inbound M&A interest since the start of 2022: five takeovers have completed, six are pending (with several set to complete in the very near term), and three companies have had approaches which have since fallen away. While M&A activity is always a double edged sword, at the very least it does help to crystallise in investors' minds the level of latent value within share prices at current levels, and provides an influx of capital for recipients to redeploy across other holdings where they see such attractive opportunity.

Another potentially very meaningful catalyst is the possibility of government policy intervention. Much has been written about July's "Mansion House Compact", which saw Chancellor Jeremy Hunt and a number of the country's largest pension funds agree to invest 5% of assets by 2030 in "unlisted equities" – a definition which includes stocks quoted on the Alternative Investment Market (AIM), where over 20% of the Fund's NAV is currently invested. Several other potential policies have also been discussed and debated by the industry and in the press, including the idea of introducing a 'Great British ISA', where savers benefiting from tax incentives would be required to invest in UK-listed companies within the ISA wrapper. We are yet to see which of these other policies may gain the most traction with policymakers, but it seems clear that, in recent weeks, the momentum has accelerated behind calls for the government to recognise the need to stimulate UK equity markets and ensure that our domestic stock market retains its status as a thriving venue for companies to list and prosper for the long term. We cannot help but feel eager to bang that drum.

Positive contributors included:

YouGov (+13%), Mortgage Advice Bureau (+8.2%), Craneware (+5.7%), Smart Metering Systems (+4.2%) and Compass Group (+3.7%).

Negative contributors included:

Alpha Group International (-17%), Keywords Studios (-16%), Spirax-Sarco Engineering (-14%), RWS Holdings (-13%) and Renishaw (-12%).

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Discrete years' performance** (%) to previous quarter-end:

	Sep-23	Sep-22	Sep-21	Sep-20	Sep-19
Liontrust Special Situations I Inc	8.6%	-16.0%	27.6%	-3.7%	2.8%
FTSE All Share	13.8%	-4.0%	27.9%	-16.6%	2.7%
IA UK All Companies	12.8%	-15.3%	32.4%	-12.8%	0.0%
Quartile	4	3	3	1	2

*Source: Financial Express, as at 31.10.23, total return (net of fees and income reinvested), bid-to-bid, institutional class.

**Source: Financial Express, as at 30.09.23, total return (net of fees and income reinvested), bid-to-bid, primary class.

For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms

Key Risks

Past performance does not predict future returns. You may get back less than you originally invested. We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

This Fund may have a concentrated portfolio, i.e. hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the Fund's value than if it held a larger number of investments.

The Fund may encounter liquidity constraints from time to time. The spread between the price you buy and sell shares will reflect the less liquid nature of the underlying holdings.

The Fund may invest in companies listed on the Alternative Investment Market (AIM) which is primarily for emerging or smaller companies. The rules are less demanding than those of the official List of the London Stock Exchange and therefore companies listed on AIM may carry a greater risk than a company with a full listing.

The Fund will invest in smaller companies and may invest a small proportion (less than 10%) of the Fund in unlisted securities. There may be liquidity constraints in these securities from time to time, i.e. in certain circumstances, the fund may not be able to sell a position for full value or at all in the short term. This may affect performance and could cause the fund to defer or suspend redemptions of its shares.

Outside of normal conditions, the Fund may hold higher levels of cash which may be deposited with several credit counterparties (e.g. international banks). A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

Disclaimer