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Economic Advantage

October 2023 review

Liontrust UK Smaller Companies Fund





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The Liontrust UK Smaller Companies Fund returned -6.3%* in October. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned -5.9% and the average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was -5.9%.

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%.

On several occasions this year we've highlighted corporate takeover activity as a theme, noting that the UK's discount to other markets and its own long-term average – particularly acute at the small cap level – is leaving some stocks vulnerable to opportunistic private equity or corporate investors.

October saw more portfolio activity in this area. **Tribal Group** (+18%) recommended a 74p-a-share cash offer from US-based Ellucian, a provider of cloud technology to the tertiary education sector. The proposed deal is a 41% premium to Tribal's prior share price. However, having initially jumped to trade close to the offer price, shares in Tribal slid to around 64p at month end after it was announced that the UK Competition and Markets Authority would be investigating the proposed deal.

It was also announced that **Alfa Financial Software's** (-19%) discussions with private equity firm Thomas H Lee Partners (THL), first disclosed in September, would not be leading to a takeover offer. This had been the second round of inbound M&A discussions for Alfa within a few months, after Swedish investment house EQT tabled a possible offer at 208p per share in June, which was subsequently pulled.

Wealth manager **Brooks Macdonald Group** (+7.5%) has been the subject of some speculation over its potential to attract takeover interest. Since its shares peaked at the end of 2021 they have underperformed the FTSE All-Share by more than 25%. They finished October in positive territory after the group announced a modest quarterly rise in assets under management – the result of positive investment performance outweighing a small net outflow – and unveiled cost cutting measures. The group plans to cut around 55 roles in a programme which will have one-off costs of around £3m but realise an annual saving of about £4m.

A profit warning from **Quartix Technologies** (-31%) cut forecasts for both revenues and earnings for this year and next. The vehicle tracking software provider grew its fleet of subscribed vehicles by 13% to 259,000 in the first nine months of the year. Overall, new units installed are ahead of the run-rate at the same time last year, but there have been notable contractions in the rate of fleet growth in the UK and USA. The company is focusing on stimulating customer base growth over the next year, following a strategic review led by Andy Walters, Quartix's founder and former CEO who has recently returned as Chairman.

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.

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:

Tribal Group (+18%), YouGov (+13%), Eckoh (+9.0%), Mortgage Advice Bureau (+8.2%) and Brooks Macdonald Group (+7.5%).

Negative contributors included:

Quartix Technologies (-31%), Alfa Financial Software (-19%), Bango (-18%), Alpha Group International (-17%) and AB Dynamics (-17%).

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

	Sep-23	Sep-22	Sep-21	Sep-20	Sep-19
Liontrust UK Smaller Companies I Inc	-1.6%	-28.9%	46.9%	12.8%	-5.0%
FTSE Small Cap ex ITs	12.7%	-24.4%	72.4%	-12.7%	-7.8%
IA UK Smaller Companies	2.2%	-31.9%	51.1%	-0.4%	-7.1%
Quartile	4	2	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.

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.

As the Fund is primarily exposed to smaller companies there may be liquidity constraints 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. In addition the spread between the price you buy and sell units will reflect the less liquid nature of the underlying holdings.

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