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Economic Advantage

December 2023 review

Liontrust UK Smaller Companies Fund

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The Liontrust UK Smaller Companies Fund returned 8.5%* in December. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned 8.8% and the average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was 7.0%.

November's broad rally extended into December as investor risk appetite continued to improve, helped along, once again, by expectations of a 'pivot' from central banks towards lower rates.

Since the prior consensus of 'higher-for-longer' rates began to break down at the start of November, the FTSE All-Share has rallied from a calendar year-to-date loss of 121 points, or 3.0%, to a gain of 157 points, or 3.9%. In total return terms the performance improved from 0.3% at the end of October to 7.9% at the end of the year.

As we observed last month, one particularly encouraging characteristic of the recent rally is the strength of small-cap and mid-cap stocks, having underperformed for much of the last two years. The mid-cap FTSE 250, FTSE Small-Cap (ex-investment trusts) and FTSE AIM All-Share returned 8.2%, 6.3% and 7.0% respectively in December, versus the 3.9% from the FTSE 100. We are optimistic that this trend may continue during 2024 as depressed share prices lower down the market cap scale could bounce strongly as investors gain sufficient confidence on inflation being under control, rates having peaked and macroeconomic gloom lifting.

Again echoing our comments from November, the rally was global in nature and extended beyond equities, so the UK stockmarket's discount to international peers remains substantial and, in our view, too wide. The catalyst to December's gains was the US Federal Reserve's publication of forecasts for interest rates to be reduced by 75 basis points in 2024, with more cuts to follow in 2025.

In this market environment, resurgent investor confidence was responsible for the majority of share price gains. This is reflected within the Fund's monthly contributors, with some large gainers rallying without issuing any new information to investors.

One of the holdings that did provide a significant update was **Smart Metering Systems** (+46%), the Fund's largest riser. It recommended a cash takeover offer of 955p from private equity group KKR, a 40% premium to its prior share price.

Following this approach, 15 companies across the Economic Advantage fund range have experienced M&A interest since the start of 2022. Of these, nine takeovers have completed, two are pending, and four companies have had approaches which have either fallen away or been voted down. 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 to redeploy across other holdings.

Gresham House left the portfolio in December on completion of its purchase by private equity group Searchlight Capital Partners.

While not a full takeover deal, **GlobalData** (+30%) also received significant investment in December which prompted a significant positive reappraisal of its share valuation. The company disclosed the sale of a 40% stake in its Healthcare division to private equity group Inflexion for net proceeds of £434m. The division accounts for just over a third of GlobalData's revenues yet the implied valuation of over £1.1bn is not far short of the company's overall £1.35bn market capitalisation prior to the deal announcement.

GlobalData will continue to operate across three divisions (Consumer, Technology and Healthcare) with 60% ownership of Healthcare, which will be treated as a fully consolidated subsidiary. GlobalData plans to invest the deal proceeds in accelerating growth, including pursuing acquisition opportunities.

A bullish update on trading from **On The Beach Group** (+59%) led to a jump in its share price. As well as reporting a 19% recovery in revenues in the year to 30 September 2023, the travel group noted that its new financial year has got off to a flying start. So far, total transaction value on its holidays is up 26% in the first nine weeks, while its forward order book is at record levels. As a result, it expects the key summer 2024 season to be "significantly ahead" of 2023.

Company news was thin on the portfolio detractors. **Frontier Developments** (-22%) continued its slide following November's profit warning while **iomart** (-6.9%) missed out on the market rally after issuing in-line financial results which failed to spark investor enthusiasm.

Due to its continuing poor financial performance and our increased concerns over the health of its balance sheet, **Frontier Developments** was sold during the month. **Concurrent** was also divested after its senior management equity ownership level fell below the 3% threshold required of all smaller companies in the Economic Advantage investment process.

Positive contributors included:

On The Beach Group (+59%), Smart Metering Systems (+46%), GlobalData (+30%), Focusrite (+29%), Brickability (+27%).

Negative contributors included:

Frontier Developments (-22%), Tribal Group (-13%), iomart (-6.9%), Big Technologies (-6.8%) and Eagle Eye Solutions (-6.7%).

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

	Dec-23	Dec-22	Dec-21	Dec-20	Dec-19
Liontrust UK Smaller Companies I Inc	-0.8%	-23.0%	24.7%	15.2%	31.0%
FTSE Small Cap ex ITs	10.4%	-17.3%	31.3%	1.7%	17.7%
IA UK Smaller Companies	0.5%	-25.2%	22.9%	6.5%	25.3%
Quartile	3	2	2	1	2

*Source: Financial Express, as at 31.12.23, total return (net of fees and income reinvested), bid-to-bid, institutional class. **Source: Financial Express, as at 31.12.23, 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.

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