Liontrust UK Smaller Companies Fund

October 2022 review

Fund managers: Matthew Tonge, Anthony Cross, Julian Fosh, Victoria Stevens and Alex Wedge

The Liontrust UK Smaller Companies Fund returned 1.6%* in October. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned 0.8% and the average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was 2.1%.

The UK equity market recovered from mid-month to post a solid gain in October, with the mid-cap FTSE 250 index (+4.5%) arresting its heavy year-to-date underperformance of large-caps although the FTSE Small Cap (ex Its) and FTSE AIM All-Share both lagged. The market rally was a global phenomenon, which was helped along in the UK by a conclusion to the latest episode of political turmoil with the resignation of Chancellor Kwasi Kwarteng, the reversal of his mini-budget measures by his successor Jeremy Hunt and the subsequent departure of Liz Truss as prime minister.

With equities enjoying a reprieve from this year's prevailing headwinds, some recent underperformers recovered ground. Sustainable investing specialist **Impax Asset Management** (+28%) has been one of the stocks most affected by rising interest rate expectations and the accompanying de-rating of high forecast growth businesses. Its shares recovered some ground in October on evidence of solid underlying inflow trends; in Q3, it recorded net asset inflows of £606m, taking its 30 September 2022 total assets under management to £35.7bn. Although this figure is down on the £37.2bn a year ago, this is due to the impact of falling markets (-£4.4bn), with net flows still positive for the year at £2.9bn, an impressive achievement given current levels of investor uncertainty

Staying with the Fund's investment management and platform businesses, a negative market movement effect of £7.4bn for **AJ Bell** (+21%) outweighed £5.8bn of net inflows in the year to 30 September to push assets under administration down 2% to £69.2bn. While the market backdrop is clearly out of its control, investors were encouraged by underlying business trends: the net inflow was underpinned by 16% organic growth in its customer base to over 425,000, with good growth for both its advised channel and its direct-to-consumer offering.

Elsewhere within the financials sector, **Arbuthnot Banking Group** (+21%) announced that it is on track to exceed consensus expectations with full-year results after Bank of England base rate rises fed through strongly to profitability. The group has around £2.6bn of assets with variable interest linked to the base rate, so it expects to benefit from abnormally high net interest margins for around 12 months until the lagged increase in deposit rates.

Professional lighting specialist **FW Thorpe** (+17%) noted that soaring energy costs have prompted a lot of discussion around how to reduce lighting energy consumption. For the majority of commercial customers, simply turning lights off isn't really an option, so they may consider energy efficient products of the type FW Thorpe supplies. In the year to 30 June 2022 the company's revenues rose 10% in organic terms, with a further 12 percentage points coming from the acquisition of Zemper. This growth was achieved despite considerable supply-chain disruption and delays for many of its components. Due to the non-discretionary nature of its products, FW Thorpe's management team expects orders to remain resilient even in a recession.

Eyewear supplier **Inspecs Group** (-64%) is one the Fund's holdings that has been more exposed to a weakening economic conditions, having already issued a profit warning in August's interim results. Its shares had another torrid month in October after it again warned on profits and also announced a senior management reshuffle which will include the retirement of its Chairman. Although sales rose 3.7% in organic terms in the first nine months of 2022, the group's order book has fallen 13% compared with a year earlier, as German and French demand in particular has been hit by declining consumer confidence. As a result of the deteriorating outlook, Inspecs is delaying (by at least a year) the planned expansion of its Vietnamese factory as well as investment in a new Portuguese facility. Inspecs expects demand headwinds to persist into 2023 and has effectively suspended its 2022 financial guidance until a scheduled January update.

Property fintech platform operator **Lendinvest** (-21%) slid on a gloomy short-term outlook for the UK mortgage market. The hybrid alternative asset manager, platform and lender matches retail and institutional investors with property finance opportunities by packaging up loans, enabling this process via an automated technology platform, and investing its own balance sheet capital to help seed new opportunities alongside its investors. While funds under management grew 17% to £3.4bn in the six months to 30 September and it has a further £950m of lending headroom, it expects buy-to-let in particular to slow in the second half of the year. It now anticipates that full-year profit before tax will only match last year's level, implying a cut of about 25% to analyst expectations.

Advanced materials and paper products manufacturer **James Cropper** (-15%) has this year seen strong revenue growth (+26% in the first half of its year) undermined by its exposure to huge increases in energy costs (+148%) and other raw materials (+20%). While it is focused on passing these costs on via energy surcharges and higher prices, it has only managed to do so in a lagged manner. In the first half of the year it managed to break-even and for the full year it now expects profit before tax of around £2m, down from prior forecasts of over £5m.

Cloud computing provider **iomart** (-17%) also slid after issuing an interim trading update which warned that profit margins are no longer expected to recover sufficiently to hit its previous full-year profit guidance.

In October, the position in **musicMagpie** was sold after the fund managers reappraised the business's possession of core Economic Advantage intangible assets (in this case, intellectual property and a strong distribution network). They found that a new market entrant's aggressive expansion has raised question marks over the strength of its barriers to competition, a key feature expected of all Fund holdings. Additionally, the managers had concerns over the scale of investment in musicMagpie's new rental business.

Positive contributors included:
Impax Asset Management (+28%), AJ Bell (+21%), Arbuthnot Banking Group (+21%), FW Thorpe (+17%) and Integrafin (+15%).

Negative contributors included:
Inspecs Group (-64%), Lendinvest (-21%), iomart Group (-17%), James Cropper (-15%) and Pebble Group (-11.6%).

Discrete years' performance (%), to previous quarter-end:**
Past performance does not predict future returns

	Sep-22	Sep-21	Sep-20	Sep-19	Sep-18
Liontrust UK Smaller Companies I Inc	-28.9%	46.9%	12.8%	-5.0%	19.7%
FTSE Small Cap ex ITs	-24.4%	72.4%	-12.7%	-7.8%	0.6%
IA UK Smaller Companies	-31.9%	51.1%	-0.4%	-7.1%	10.8%
Quartile	1	3	1	2	1

*Source: Financial Express, as at 31.10.22, total return (net of fees and income reinvested), bid-to-bid, institutional class.
**Source: Financial Express, as at 30.09.22, 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/glossary

Key Risks:

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.

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.

The portfolio is primarily invested in smaller companies and companies traded on the Alternative Investment Market. These stocks may be less liquid and the price swings greater than those in, for example, larger companies.