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Economic Advantage

November 2023 review

Liontrust UK Smaller Companies Fund

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The Liontrust UK Smaller Companies Fund returned 6.4%* in November. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned 4.0% and the average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was 6.0%.

Evidence of decelerating inflation helped propel a broad rally across asset classes, with investors largely disregarding central bankers' efforts to promote the possibility of further policy tightening. By the end of the month, financial markets had moved to price in a peak at current interest rates in the US, UK and eurozone.

We've recently highlighted the low valuation of UK stocks – particularly small caps – relative to both their own history and to other international equity markets. While the former of these two discounts narrowed slightly during November's strong equity market performance, the rally was global in nature, meaning that the UK still sits at a substantial valuation discount to other markets. We think this represents a very compelling longer-term investment opportunity in UK stocks.

YouGov (+21%) continued the 'relief bounce' we commented on last month, following its solid set of full-year results which confirmed trading in the new year has begun in line with expectations. The fact that stocks are experiencing such strength on the back of merely 'in-line' statements remains emblematic of the level of pessimism currently priced into many share prices.

This month, data driven consultancy **Next 15 Group** notched up an 18% gain following a trading update and capital markets data at which it maintained revenue and profits guidance for the full year to 31 January 2024 and outlined bolder longer-term growth plans. While many of its peers are experiencing softer demand, Next 15 is showing some resilience: in the three months to 31 October, it generated organic net revenue growth of 2.5% a similar rate to the first six months of the year.

Dotdigital Group (+24%) and **Gateley Holdings** (+23%) also made sizeable gains on the back of solid statements.

Dotdigital Group reported a 10% rise in revenue in the year to 30 June as it saw growth in all regions. The omnichannel marketing automation specialist also noted that it has had an encouraging start to its new financial year, with the acquisition of the Fresh Relevance business accelerating its AI functionality and next-generation customer experience data platform.

In a trading update covering the six months to 31 October, commercial law firm **Gateley Holdings** described activity levels improving throughout its second quarter. Revenue grew by around 7% to over £81.5m, with underlying profit before tax on course to exceed £10m, growth of 4%.

Despite a backdrop of much improved investor sentiment in November, the environment is still one in which trading setbacks are being heavily penalised. **Pebble Group**, for example, fell 39% after lowering its 2023 revenue guidance due to reduced order intake at its Brand Addition unit. This promotional products division has seen lower demand from the technology and consumer sectors. Pebble's Facilisgroup division – a digital commerce platform for promotional products – continues to trade robustly. Pebble now expects revenues of £124m, lower than the £134m achieved last year. This negative impact will be partially offset by improved margins.

Video game developer **Team17 Group** (-38%) also fell heavily. It updated that it expects 2023 revenues to be modestly ahead of market expectations but has seen an unfavourable shift in the sales mix between higher-margin own-IP titles and less lucrative third-party games. A trading update also disclosed that it has incurred cost overruns on some projects. As a result, Team17 has downgraded its profit forecast for the year.

Fellow video game specialist **Frontier Developments** (-38%) tumbled after issuing a trading update which warned that sales of its *Warhammer Age of Sigmar: Realms of Ruin* game – released just 10 days earlier – had been disappointing. It has downgraded its sales forecast for the year to 31 May 2024 from £180m to a wide £80 - £95m range.

Advanced materials, luxury packaging and paper products producer **James Cropper's** (-19%) £57m revenue in the half-year to 30 September – down 8% on last year – was only "broadly" in line with its expectations as its Paper Products unit continued to face market headwinds. The division is being restructured, a process which is expected to complete by year end. Cropper's Advanced Material's division continues to post strong growth.

Eckoh (-15%) reported a 4% decline in revenues for the half-year to 30 September after the loss of a large UK client – already disclosed to the market several months ago. Eckoh is transitioning to cloud-based delivery of its products, a process which it says is tempering growth in the short term but having a positive impact on recurring revenues, raising the visibility of its earnings.

The positions in **Instem** and **Ergomed** both left the portfolio in November as their respective takeovers completed.

Overall, it was notable that there was a more 'risk on' feel to the market in November, with investors looking through short-term trading headwinds for more cyclical names. The outperformance of mid and small-caps was another welcome sign of improving investor appetite for the UK market. The large-cap FTSE 100 has fairly relentlessly outperformed for the last two years, so it was encouraging to see the FTSE 250, FTSE Small-Cap (ex-investment trusts) and FTSE AIM All-Share return 7.1%, 4.0% and 5.3% respectively, versus the 2.3% from the FTSE 100. As we move towards the New Year, we are optimistic that the depressed share prices in this area of the market are due a strong bounce as investors gain sufficient confidence on inflation being under control, rates having peaked and macroeconomic gloom lifting.

Positive contributors included:

Mortgage Advice Bureau (+25%), Dotdigital Group (+24%), Mattioli Woods (+23%), Gateley Holdings (+23%) and YouGov (+21%).

Negative contributors included:

Pebble Group (-39%), Team17 Group (-38%), Frontier Developments (-38%), James Cropper (-19%) and Eckoh (-15%).

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 30.11.23, 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.

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