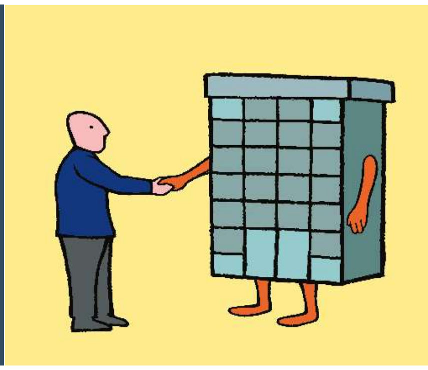
ASSET MANAGEMENT

UK INCOME FUND

Investment Commentary
Q2 2024



Market review

Conditions in equity markets during the first half of 2024 continued to be dominated by two main themes: stickier-than-expected inflation and the ongoing domination of the large technology stocks in the US. In both the US and UK, stubborn services inflation led Central Banks to delay interest rate cuts. This had a negative impact on smaller companies which are more interest rate sensitive compared to their larger peers.

LargeCap technology stocks – and in particular anything “A.I” related – performed strongly. The shadow cast by more glamorous international markets remained long. In June, Nvidia became worth more than the entire FTSE 100.

Towards the end of the second quarter, political upheaval weighed on most parts of the equity markets. The UK faced an election and a change of government, while in France a snap election was called by Emmanuel Macron, which raised market volatility. In the US, the pre-election bandwagons began to roll.

Despite this, something was happening beneath the headlines in the world of SmallCap. A strong Q2 meant that the asset class moved ahead of its LargeCap peer over both 3 and 12 months in the UK. Investors, it seemed, were beginning to recognise both the quality and the value on offer in the UK smaller companies space.

Portfolio

During the quarter, the NAV of the Sterling seed share class rose by 5%, an outperformance of 1% versus the benchmark index.

The strongest contribution during the quarter came from **Britvic**, the soft drinks bottler, which received a takeover proposal from Carlsberg. **XPS Pensions**, the pensions consultant, rose on the back of another strong set of results. **Bloomsbury Publishing**, the leading independent publishing house, rose following good results and its acquisition of Rowman & Littlefield's academic publishing business, which strengthened its position in North America.

The weakest contribution came from **Sage**, the leading accounting software provider, which drifted following a slightly soft outlook statement. **DiscoverIE**, the designer and manufacturer of components for electronic applications, and **4imprint**, the supplier of promotional merchandise, both drifted despite posting in-line updates.

Outlook

At the end of 2023 we suggested that the conditions might be ripening for the "SmallCap Effect" to emerge from its multi-year hibernation. There are signs that a thaw may have begun. Something of a "silent recovery" is at play. Over the past 12 months, SmallCap has outperformed LargeCap by over 1%. Although few commentators seem to have noticed, UK SmallCap fared significantly better than its European and global contemporaries over the past quarter.

Investors appear to be growing concerned about the "concentration risk" in global markets. Some recent research that we found interesting was published by Bridgewater: *The life cycle of market champions*: *"a consideration for investors today is that most investors' portfolios have higher exposure than ever to the current champions [the large tech stocks]… over a third of a typical US-market-weighted portfolio is allocated to the current basket of champions, and in a world portfolio, this share ends up close to 20% - the highest in over 50 years"*.

The P/E discount of UK SmallCap to global equities now stands at -39%. The

Price/Book discount v. LargeCap is at its widest since 2009. There has been a notable pick-up in M&A activity in the SmallCap space as trade buyers and private equity are taking advantage of low valuations. The IPO market is looking healthier than it has done for some time. Things feel a little better these days at least in the world of UK SmallCap. Shhhhhh whisper it for now. No-one seems to have noticed …

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