

Economic Advantage

May 2024 review



Liontrust UK Micro Cap Fund



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The Liontrust UK Micro Cap Fund returned 0.7%* in May. The FTSE Small Cap (excluding investment trusts) Index and the FTSE AIM All-Share Index comparator benchmarks returned 6.7% and 6.1% respectively. The average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was 6.0%.

Neither higher-than-expected UK inflation nor the potential uncertainty from an early-July election could derail UK shares this month, as buoyant investor sentiment pushed global stock markets higher.

UK consumer price inflation dropped to 2.3% in April – down from 3.2% in March but still higher than the 2.1% expected, pushing back the market’s assessment of when the first Bank of England rate cut will arrive. Although expectations for interest rate cuts in 2024 continued to moderate on both sides of the Atlantic in May, investors took heart from a building picture of economic and corporate resilience.

Encouragingly, sentiment towards UK equities appears to be on an improving trajectory. Economic growth, while muted, has turned positive, with the 0.6% expansion registered during the first quarter of 2024 the fastest growth in two years. The UK is heading for a general election on July 4 and, if the polls are to be believed, a stable majority government will likely be formed which should provide a supportive market backdrop. When combined with inflation which – while decelerating slower than expected – is heading towards target, this has paved the way for a more constructive outlook for UK equities.

While this renewed enthusiasm has, to date, predominantly been of benefit to larger companies within the FTSE 100, May saw encouraging signs of a pickup in appetite for smaller companies. While the FTSE 100 rose 2.1%, the FTSE 250 mid-cap index gained 4.2% and the FTSE Small Cap (ex-investment trusts) Index rose 6.7%. The FTSE AIM All Share Index has been particularly weak during the bout of small-cap underperformance in recent years, but it gained 6.1% in May.

Despite this incremental improvement in the sentiment towards UK equities, however, valuations of UK listed companies – and in particular small caps - remain substantially lower than their long run average and their global peers.

As the fund managers have highlighted on several occasions in recent months, these low valuations mean many UK companies have proven susceptible to takeover approaches from private equity or corporate acquirers keen to exploit the opportunity.

Zoo Digital Group (+40%) was one of the Fund's largest risers in May. The company provides localisation and dubbing services to globalise TV and movie content, underpinned by an innovative, cloud-based platform. Following a very tough 2023 due to the Hollywood writers' and actors' strike, Zoo Digital rallied strongly on some early signs of a recovery in activity.

A trading update described customer demand in March 2024 as the highest since April 2023, following an acceleration of its pipeline. This demand recovery was maintained in April, and Zoo Digital commented that it now has good visibility on activity levels through to September. It now expects results for the year to 31 March 2024 – scheduled for August release – to be “at least” in line with market expectations.

Commercial law firm **Gateley Holdings** (+15%) issued an upbeat trading update predicting revenues of at least £172 million in the year to 30 April, a 5.7% expansion, and underlying profit before tax of £22.8 million. The company commented that it had experienced strong activity levels in Q4 which leave it well positioned heading into the new financial year.

During 2023, **EKF Diagnostics** (+13%) divested underperforming units and implement cost-cutting measures in reaction to a drop-off in demand for Covid testing. The company is now focused on the core point-of-care and life sciences divisions, a decision which is already benefiting margins; in the first quarter of 2024, EBITDA improved 20% year on year. Overall, trading in the quarter was in line with the company's expectations and it has maintained its 2024 targets. They also provided an update on the new fermentation facility, which had previously been delayed, it is progressing as expected and contract fermentation services were up 156% (from a low base).

While the supportive market backdrop allowed **32** of the portfolio's 55 holdings to finish May in positive territory, the Fund's participation in the small cap rally was restricted by a few stocks suffering heavy declines.

One of these large fallers was **Inspiration Healthcare** (-44%). It released a trading update at the start of 2024, warning that results for the year to 31 January 2024 would fall short of expectations due to a delay in receiving a large export order. In a May update, the company commented that it is still yet to receive the order. While Inspiration still expects to receive the order this year, it has been necessary to seek waivers from end-April covenant tests on its debt. It has arranged modified covenants due next year, but it would have to seek alternative funding should the export order not materialise.

CMO Group (-41%) also tumbled after reported on a worse-than-expected fall in demand during 2023 as cost-of-living pressures and unusually wet weather depressed the domestic construction sector. The decline was particularly sharp within tiles, where sales fell 31%. CMO's overall revenue dropped 14% to £72 million during the year. While the wet weather and weak demand carried over into Q1 2024, CMO has seen some signs of improvement in Q2.

The team continues to seek to take advantage of low valuations and market dislocations amid the UK small cap market. Two holdings have recently been added to the portfolio: **Focusrite** and **Gaming Realms**.

Focusrite is a global music and audio products group that develops and markets proprietary hardware and software products used by audio professionals and amateur musicians. It is currently held in the Liontrust UK Smaller Companies Fund and Liontrust Specials Situations Fund due to the significant strength in IP of its products as well as broad international footprint across 240 territories. It also has a strong culture and brands. Focusrite

was held in the fund previously and sold when it became too large in 2019. However, the company's market cap returned to the Fund's range following some destocking and other post-Covid unwinds.

Gaming Realms is an international developer, publisher and licensor of mobile games, building a portfolio of highly popular gaming content and brands with the most significant being the game Slingo. The game has a unique "game mechanic" which is a large part of its popularity and the name Slingo has also become an important source of IP in its own right. The game is increasingly global in nature with the US presenting a large opportunity as states change their online gambling rules.

Positive contributors included:

Essensys (+77%), Zoo Digital (+40%), IG Design (+28%), Gateley Holdings (+15%) and EKF Diagnostics (+13%).

Negative contributors included:

Inspiration Healthcare (-44%), CMO Group (-41%), Eckoh (-19%), Microlise (-18%) and Tristel (-9.7%).

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

	Mar-24	Mar-23	Mar-22	Mar-21	Mar-20
Liontrust UK Micro Cap I Acc	5.8%	-7.1%	2.0%	67.6%	-8.2%
FTSE Small Cap ex ITs	11.0%	-12.9%	5.5%	74.9%	-24.4%
FTSE AIM All Share	-6.3%	-21.2%	-12.1%	76.9%	-24.5%
IA UK Smaller Companies	5.0%	-16.6%	-1.7%	65.7%	-17.9%
Quartile	2	1	1	2	1

*Source: Financial Express, as at 31.05.24, total return (net of fees and income reinvested), bid-to-bid, institutional class. **Source: Financial Express, as at 31.03.24, total return (net of fees and income reinvested), bid-to-bid, institutional 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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