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Economic Advantage

May 2024 review

Liontrust UK Smaller Companies Fund

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The Liontrust UK Smaller Companies Fund returned 4.1%* in May. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned 6.7% and 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.

The Fund's two holdings in UK investment platform providers performed well in May as both reported results. AJ Bell (+19%) recorded 27% growth in revenue to £131 million in the six months to 31 March, while profit before tax margins rose six percentage points to 46.8%. The company added 27,000 customers to take the total to over half a million. Assets on its platform rose to over £80 billion following net inflows of £2.9 billion during the six months and favourable market movements of £6.5 billion. The results were stronger than expected – partly due to a delay in introducing a new set of lower client charges – so AJ Bell has raised its full-year guidance.

Fellow platform operator IntegraFin Holdings (+17%) also reported good growth in assets. Funds under direction on its Transact platform rose 13% year-on-year to £61 billion by 31 March 2024 following £1.1 billion of net inflows and a £5.0 billion positive market movement. Client numbers rose 1% to 228,000 while the adviser base increased 4% to 7,849. IntegraFin has maintained its financial guidance for the year to 30 September 2024.

While the supportive market backdrop allowed 42 of the portfolio's 60 holdings to finish May in positive territory, the Fund's participation in the small cap rally was somewhat restricted by a few stocks suffering double-digit declines. Eckoh (-19%) was one of these. The provider of secure payment products and customer contact solutions 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. It has also experienced some elongation of sales cycles recently. As a result, it expects to report revenues of £37.2 million for the year to 31 March – down 4% on last year's level and slightly behind expectations. However, adjusted operating profit is expected to be marginally ahead of forecasts at £8.3 million, 17% higher than last year. The higher proportion of cloud-based software-as-a-service revenues boosted margins and cash conversion.

Specialist on-trade audio-visual equipment distributor Midwich Group (-10%) also fell on signs that last year's tough trading conditions have extended into 2024. In an AGM statement, Midwich described a mid-single digit decline in organic revenue this year, in line with last year but below its prior expectations for growth. The company believes that the delay in cuts to central bank interest rates has deferred a recovery in its markets. It now expects 2024 full-year adjusted operating profit to be similar to last year's level.

Arbuthnot Banking Group (-8.5%) lost some ground despite its AGM update being in line with market expectations but also cautioned the potential impact of prevailing macroeconomic uncertainty. Its overall loan balances rose 6% year-on-year to £2.37 billion as of 30 April. Deposits were £3.6bn which was a 3% reduction year to date but 12% increase year on year. Assets under management was up 10% year-to-date and up 12% year-on-year to £1.9bn driven by both strong net inflows and positive market movements. The bank has benefitted from net interest margin but has sought to counter the pressure when this reverses by increasing the level of Gilts comprising of liquid assets and by growing thier fixed-rate lending.

Positive contributors included:

AB Dynamics (+22%), Team17 Group (+20%), AJ Bell (+19%), IntegraFin Holdings (+17%) and Craneware (+16%).

Negative contributors included:

Eckoh (-19%), Microlise Group (-18%), Midwich Group (-10%), Tristel (-9.7%), and Arbuthnot Banking Group (-8.5%).

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

	Mar-24	Mar-23	Mar-22	Mar-21	Mar-20
Liontrust UK Smaller Companies I Inc	3.8%	-14.7%	2.6%	56.7%	-5.8%
FTSE Small Cap ex ITs	11.0%	-12.9%	5.5%	74.9%	-24.4%
IA UK Smaller Companies	5.0%	-16.6%	-1.7%	65.7%	-17.9%
Quartile	3	2	1	3	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, 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.

Disclaimer