Unicorn Asset Management

Q4 Fund Commentary

UK Smaller Companies Fund

Market Review

Global equity markets finished the year strongly as inflation data came in below forecasts and interest rate expectations moderated markedly in the final quarter. The UK economy performed materially better than low-balled expectations in 2023. This led to a slew of GDP growth upgrades during the year. This dynamic was particularly supportive for UK small and medium sized companies, which outperformed their larger quoted peers during the quarter; the first period of quarterly outperformance since the Q3 2021. The strong performance in the final two months of the period was in contrast to a weak October, which saw a rapid escalation of the conflict in Gaza.

Performance Activity & Fund Commentary

The Fund delivered a strong return of +9.0% during the quarter, outperforming the Numis Smaller Companies (ex IC) plus AIM Index and IA UK Smaller Companies peer group, which generated total returns of +6.9% and +6.8% respectively.

The largest contributor was Somero, which added 1.1% in Fund performance terms, its share price recovering strongly from the November lows despite an absence of news flow. Another strong performer was Peel Hunt, adding 0.9% to Fund performance. Other notable contributors included Ocean Wilsons and Smart Metering Systems. In June, Ocean Wilsons announced a strategic review of its investment in Wilsons Sons, updating the market further in November stating that it had received a number of indicative non-binding offers. A positive outcome to the strategic review has the potential to realise a large element of the current discount to net asset value, which currently sits at approximately 50%. Smart Metering Systems (+0.8%) received a recommended offer of 955p per share from KKR pricing the shares at a 40% premium.

There were three notably disappointing performers: Frontier Developments, Pebble Group and Calnex but damage to Fund performance was contained at 1.6% given the relatively small position sizes reflecting the current higher risk profile of the holdings.

A position in AJ Bell was initiated during the quarter. This is a high quality, structural growth company which has seen a significant devaluation and is well positioned to capture cyclical upside. The Fund's positions in Frontier Developments and 4imprint were exited in full.

Outlook & Positioning

The outlook for 2024, while remaining uncertain, shows signs of promise, and at the point of writing, the prospect of runaway inflation appears to be in the rearview mirror. The phase of rapidly rising bond yields and the consequential compression of equity valuations seems to be over, and the next challenge for investors will be to navigate an uncertain earnings backdrop. Higher interest rates have had the desired effect of reducing inflation, and to date, economies have performed resiliently.

It is widely expected that interest rate cuts will be required in the current calendar year to avoid a recession, the timing and magnitude of which will pose a considerable challenge for central banks. Not to mention a volatile geopolitical backdrop, with war raging in both Ukraine and the Middle East, and a busy year of elections, with more people set to vote in 2024 than in any other year of recorded history. Notwithstanding this somewhat dramatic backdrop, we are confident that our diversified portfolio remains well positioned to withstand current headwinds and thrive when market conditions improve.

Source: Unicorn Asset Management FE Analytics (mid-mid, total return), and Bloomberg, 31 December 2023
Past performance is not a guide to future performance, performance is based on returns net of fees. Your capital is at risk, the value of investments and the income from them may go down as well as up. Investors may not get back the amount of their original investment.

Unicorn
Investing with conviction

The portfolio remains well capitalised with nearly half of the constituents having positions of net cash on their balance sheets and gearing modest in the balance. The largest sector weight is Investment Banking and Brokerage Services, which accounted for 17% at the end of the period. At the stock level the business models are differentiated and diversified, and we are optimistic about not only the long term growth opportunity of each business but also the cyclical recovery potential.

Valuations within the portfolio remain compelling. The average discount to 10 year average P/E ratio is approximately 30%, representing significant recovery potential in a more constructive market environment towards UK small cap stocks.

Source: Unicorn Asset Management FE Analytics (mid-mid, total return), and Bloomberg, 31 December 2023
Past performance is not a guide to future performance, performance is based on returns net of fees. Your capital is at risk, the value of investments and the income from them may go down as well as up. Investors may not get back the amount of their original investment.