Fund Managers: Richard Penny

This is a Marketing Communication

TM CRUX UK Core Fund

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Market Performance

The FTSE 100 rose over the quarter but lagged mid and small caps due to higher exposure to underperforming energy stocks. The FTSE 250, FTSE Small-cap and FTSE AIM All-Share drifted lower during October before rebounding strongly amid growing confidence that base interest rates may have peaked, potentially paving the way for rate cuts in 2024 if inflation continues to fall.

Fund Holdings Q4 2023

Top 5 Holdings (by %)
Shell (5.70)
Glaxosmithkline (5.41)
Legal General (5.33)
Imperial Brands (5.18)
Smith and Nephew (5.04)

Source: CRUX as at 31.12.23

Fund Performance

Over the period under review, the TM CRUX UK Core Fund (B Income GBP) returned 4.2% against its performance comparator the IA UK All Companies Sector return of 4.5%.

The fund's large allocation to mid and small cap, representing c.50% of the fund, was generally helpful for performance over the quarter as these segments of the market outperformed large cap, particularly in November and December.

OneSavings Bank Group was the strongest performer over Q4, up c.42% and contributing c.1.6% to fund performance. A trading update in July included a one-off accounting charge due to landlord clients refinancing at a faster rate than expected which led to a material sell-off of the shares. This represented a large overreaction in our view and a strong trading update in November helped reduce the market's concerns and the shares have rallied strongly.

DCC was another strong performer, contributing c.1% to fund performance following an update which signalled an improving picture in DCC's Healthcare segment and its related end-markets, and an ability to control costs in the face of ongoing pressures in the Technology segment's end-market. There was also a positive reaction to DCC's acquisition of Progas and the implications for the company's strategy in its Energy business.

Legal and General contributed c.0.7% to fund performance over the quarter as fears of credit risk and real estate valuations appear to be subsiding. L&G continues to deliver strong cash generation and a growing dividend.

FD Technologies shares fell, detracting c.0.7% from performance over the quarter, following an announcement of a reduction in near-term expected profits. This was partially due to weaker trading in its consulting division which was not wholly unexpected in our view. There was a bigger impact from further investment in the KX division to advance opportunities in Artificial Intelligence, and specifically vector databases. We continue to believe that the sum of the parts is materially undervalued, and we welcome the announcement of a strategic review of the group which could realise some unrecognised value. The shares have recovered strongly since the trading update.

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Dr Martens detracted c.0.7% from fund performance over the quarter after a trading update noted weaker US performance and slower than expected restocking from wholesale partners. At its core, the Dr Martens brand remains an attractive, high-margin, globally relevant heritage brand with very little fashion risk in our view.

Transactions

In terms of transactions, Tesco and Zegona Communications were added to the portfolio. Tesco is very focused on fulfilling the potential of its core retail markets, importantly seeking to sustain and, if possible, grow UK grocery market share. Inflation has been the dominant feature of the UK food market for some time. That domestic food inflation is easing back is to be welcomed, especially if it can lead to improving volume and mix on an ongoing basis. Tesco has a strong financial backbone with low non-lease leverage, material fixed asset backing, and a comfortable pension position.

The fund participated in a fundraise by Zegona Communications which is in the process of acquiring Vodafone Spain for €5bn. The acquisition is synonymous with a private equity style deal, with the acquisition predominantly funded with debt and €300m equity raised. The impressive management team of Zegona are highly experienced and have a history of value creation, having generated a shareholder return of c.87% at Euskaltel in 2 years, a c.42% return at Telecable in less than 2 years and a 6x return in c.8 years at Jazztel.

We believe that Zegona have acquired Vodafone Spain at a highly attractive price and due to management’s experience in the sector, we believe in their ability to execute a major cost reduction plan and deliver significant cashflow upside. We believe there is a further opportunity for Zegona to realise value from the deal extremely quickly through monetising Vodafone Spain’s fixed network via a sale to an infrastructure investor. There is also scope to combine the fixed network with other major operators in Spain to form an even more attractive monetizable fixed network asset. Similar transactions are taking place in the market currently with smaller competitor Digi in talks to sell its Spanish fibre network

Outlook

The UK stock market is trading at a 30-year high discount relative to the global market, the FTSE 250 is pricing in c.30% earnings cuts (close to that experienced during the global financial crisis of 2008/2009) and small-caps have experienced 2 of the worst 6 years on record since c.1955 in succession. Although past performance is no guide to future returns, periods of weak returns have historically been followed by periods of very strong performance, particularly in small caps. The economic outlook remains uncertain but financial crisis levels of pessimism are already priced into shares despite signs of economic resilience. We remain firm believers in the small-cap premium and the potential for small companies' share prices to go up many multiples on the way out of a recessionary environment, as was demonstrated by the fund's outperformance on the way out of the pandemic, and by Richard Penny's previous funds during the 1998, 2003 and 2008 recoveries. We believe current depressed conditions offer a strong opportunity to buy well-run sensibly financed businesses for the long term.

