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TM CRUX UK Core Fund

We believe that valuations being close to historic lows in the UK, 33 consecutive months of outflows depressing share prices and being on the cusp of UK interest rate reductions and an economic recovery sets up the potential for a phase of strong performance for the fund.

Market Conditions

Whilst the UK economic growth backdrop is below its long-term trend, it has recently outperformed previous expectations and the February Monetary Policy Report saw the Bank of England raise its profile for GDP growth across the forecast horizon. The latest GDP data suggests that the UK's 'very small recession' is already over, with surveys pointing to a recovery in activity around the end of last year.

UK inflation is falling faster than the Bank of England's forecasts published in November 2024 and wage growth has turned positive in real terms after the 'real incomes shock' of 2022. Inflation should continue to fall faster than real wage growth through 2024 and the falling gas price has stayed low, providing some relief to households. Consensus currently points to June 2024 as the beginning of interest rate cuts by the Bank of England.

The UK stock market has experienced 33 consecutive months of outflows and this has impacted investor behaviour in a number of ways:

1) There has been a significant rotation into defensive and large-cap companies. Bad news is punished disproportionately, even when a lot of bad news is already reflected in the share price.

2) Momentum has been outperforming value. Globally, capital has flowed into the US market which is led by the Magnificent 7 and flowed out of unloved economies such as the UK, with small and micro-cap companies hit hardest due to lower liquidity. The disparity in valuations between markets is well illustrated by insiders selling their own stocks in the US (Jeff Bezos $8.5bn, Mark Zuckerberg $135m in February 2024 & Peter Thiel, $175m in March 2024) and external institutions launching takeover bids in the UK with M&A activity up 88% YoY and almost half of approaches coming from overseas.

3) Notwithstanding some remaining economic headwinds, out of favour cyclicals and small and micro-caps are frequently trading at cyclically low valuation multiples on depressed earnings. External buyers with a medium-term view are taking advantage of this through M&A.

Falling UK interest rates, currently expected to begin in June, should lead to a positive backdrop of value and momentum and a reversal of point 1 above. We have seen the start of a recovery in mid-cap cyclicals, but this is yet to flow down into the small and micro-caps which make up roughly a quarter of the fund.

Fund Performance

Over the period under review, the TM CRUX UK Core Fund (B Income GBP) returned -2.2% against its performance comparator the IA UK All Companies Sector return of 2.9%.

After a rally towards the end of 2023, the UK market moved lower over the first two months of the quarter as the UK was confirmed to have entered a technical recession and overly optimistic interest rate expectations settled. The UK market picked up again during March following more encouraging economic data. The fund's large allocation to mid and small-cap, representing c. half of the fund, was generally unhelpful for performance over the quarter as these segments of the market were outperformed by large cap. However, as discussed above, in an environment of improving economic conditions and falling interest rates, we would expect the mid and small-cap segments of the fund to outperform materially.

Performance was held back by three notable detractors which reported disappointing trading updates. Watches of Switzerland was the largest detractor over the quarter, down c.45% and detracting c.1.4% from performance, after reporting that sales were weaker than expected over the Christmas period and these trends were likely to continue for longer than originally expected into 2024. Management also noted that their original forecasts for 2024 were inaccurate due to overoptimism regarding the supply of higher priced watches from Rolex.

PZ Cussons was down c.41% over the quarter and detracted c.1.4% from fund performance. The interim results were significantly affected by the devaluation of the Nigerian Naira which moved the company into a loss-making position. On a constant currency basis, operating profit was up c.17%. Although the Nigerian business is a material headwind to the business and to investor sentiment, we believe the share price reaction has been overdone relative to the contribution of Nigeria to the overall PZ Cussons business.

One Savings Bank (OSB) was another poor performer during the quarter following softer guidance for 2024 and the shares down c.19% over the quarter, detracting c.0.8% from fund performance. A lower Net Interest Margin was guided for 2024, driven by the fixed deposit book repricing and the market getting more competitive in deposit taking. Although disappointing, the shares were already trading at a low level with difficult trading already priced in in our view. With a c.12% cash return expected in 2024, we believe investors are being well compensated whilst the shares are valued below book value which is far too low in the context of a return on tangible equity of c.20%.

AdvancedADVT was the strongest performer over the quarter and was also a large position in the fund, up c.55% and contributing c.1.9% to fund performance. The shares recommenced trading in mid-January, having been suspended at 82p

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following the acquisition of 5 software businesses from Capita which constituted a reverse takeover. The shares were valued at a discount to cash at the time of suspension and bounced c.20% immediately on resumption of trading. Since then, the shares have made more progress as a trading update outlined performance that was ahead of expectations, significantly aided by pricing action taken by management. We expect further progress to be made with the acquired Capita businesses over the medium-term and with a substantial cash balance remaining, we expect additional acquisitions to be made at attractive valuations.

Beazley was another strong performer during the quarter, returning c.30% and contributing c.0.9% to fund performance. Beazley released an unscheduled trading update in February which guided to a better underwriting experience for 2023 than expected, paving the way for material capital returns to investors which later materialised at the full-year results in March in the form of a major buyback, after doubling profits in 2023. Operational delivery is strong and so is the outlook. We believe further upside remains with the shares trading on just 1.2x book value against ROEs of >20%, and with the prospect of double-digit yields.

GSK returned c.19% during Q1 2024 and contributed c.0.8% to fund performance. The company reported Q4 results ahead of consensus which brought full-year numbers in towards the upper-end of guidance which it had already upgraded at the Q3 results. Vaccines beat expectations by c.6% with GSK's recently launched RSV vaccine, Arexvy, surpassing expectations by c.40%. Having only launched in H2, this vaccine can already claim blockbuster status with 2023 sales totaling c.$1.6bn and GSK is taking the lion's share of this opportunity in RSV prevention, with Pfizer's competitor vaccine booking less than $1bn of sales in 2023. Sustaining this impressive launch momentum could provide near-term upgrade potential in our view.

Transactions

In terms of transactions, Grafton and DCC were sold on valuation grounds after reaching our price targets. A portion of the proceeds were used to purchase Breedon following the announcement of the firm's first acquisition in the US at an attractive valuation. We believe this represents the beginning of the next phase of growth for Breedon, transitioning from the UK aggregates market which has been through decades of consolidation to the US aggregates market which remains highly fragmented.

The fund's exposure to the industrials sector was increased through buying shares in Victrex which is materially undervalued in our view. The shares trade at the lower end of historic valuation multiples, on depressed earnings and also carry an attractive dividend yield. Despite destocking challenges in the recent past, there have been signs of volume progress in Q1. Small improvements in volumes have the potential to significantly improve profits.

Small-cap Hostelworld was added to the portfolio during the quarter. Hostelworld is an Online Travel Agent (OTA) focused on the hostelling category, where it is one of the market leaders. Unlike other OTAs, its app offers a number of social-network-based features (recently launched), allowing its guests to interact with one another before, during and after their stay, and to organise joint activities. The full-year 2023 results provided several strategic proof points demonstrating the increasing traction of its unique social network, with 74% of bookings now coming from members, reducing cost of customer acquisition and marketing spend requirements.

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Outlook

The fund is well positioned for an economic recovery and falling UK interest rates, currently expected to begin in June, which should lead to a positive backdrop of value and momentum and a reversal of the outperformance of large-cap defensives experienced over the past couple of years.

We believe that valuations being close to historic lows in the UK, 33 consecutive months of outflows depressing share prices and being on the cusp of UK interest rate reductions and an economic recovery sets up the potential for a phase of strong performance for the fund. External institutions launching takeover bids in the UK, with M&A activity up 88% YoY and almost half of approaches coming from overseas, is a strong indication of value and should help to mitigate the impact of outflows from the UK market in the interim.

Although the fund was 'too early' in pivoting towards a cyclical recovery, we believe that falling interest rates will be a strong catalyst to encourage investors to look through to the significant medium-term potential of cyclical businesses. We expect the small and mid-caps within the fund to be a key driver of performance in the event of falling UK interest rates and an economic recovery.

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