

SVS Dowgate Wealth UK Small Cap Growth Fund Monthly Commentary: 30 December 2022

PERFORMANCE

The fund fell 1.2% in December after a good November. During the month, the top contributors were **Wandisco**, **On The Beach** and **Crestchic**, which were subject to a takeover bid. Our worst performers were **Alpha Group**, **Watches of Switzerland** and **THG**.

Wandisco is now our largest holding, and has been the top contributor to the fund's performance since its launch. We started buying the shares at 290p. After several upgrades and large contract wins, **Wandisco** ended the year with \$116m in forward bookings, nearly 10-fold from the prior year.

Wandisco is an IP company with applications in the telecoms and automotive industries. The business is a data activation platform, which helps companies move data at scale with zero downtime, data loss or disruption. After two false dawns under the existing management, **Wandisco's** prospects have improved materially.

There is a proven pain point with hyperscalers moving data. Providers like **AWS** and **Azure** prefer customers to hold data in their cloud. However, increasingly, customers want to transfer data to edge networks and IoT sensors. As an **Azure** first-party service native application, **Wandisco** has a scalable product with a quick time to market, a proven sales channel, and a robust business model with excellent sales and contract momentum.

The year-end bookings figure of \$116m could drop to revenue over the next 12-16 months. The company's high gross margins will transform profits beyond current analyst expectations if this happens.

Of course, the shares are not without risk and have had a good run, but we believe they could still have a long way to go.

PORTFOLIO ACTIVITY

We took some profits in **Kainos** and **Discover IE** during the month, after we felt the ratings had run too far. We also reduced our exposure to energy stocks, including **Serica** and **Hunting Group**. These sales, combined with the takeover of **Crestchic**, meant we finished December in a higher cash position than usual. We invested in new positions

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in **Capital Ltd**, **Foresight Group** and **Elementis**. We continue to look for new ideas.

We believe the UK equity market has de-rated most of what we might expect due to higher interest rates. According to broker **Cenkos**, UK small and medium-sized companies, as measured by the MSCI index, are currently trading at a price-to-earnings ratio (P/E) of 10x, compared to 17x for US indices, one of the widest discounts on record. In the UK, a below 10x P/E ratio has only occurred 11% of the time in the last 30 years. During this period, the average 12-month return for smaller companies with a P/E ratio under 10x was 35.9%.

The signs of a bottom in UK equities are starting to appear. We are especially interested in news reports announcing a consensus of economists' forecasting the UK's longest-ever recession, followed by the weakest recoveries among the G7 nations. Buffet famously said he had never made a decision based on an economic prediction, and that any company with an economist 'has one employee to many'.

INVESTMENT OUTLOOK

We are closely watching for signs that the stock market is prepared to look through near-term earnings risk toward the UK's upside potential. Regardless of our disdain for economists' consensus, the UK economy doesn't necessarily represent the UK stock market, where many companies have businesses and revenue lines all over the globe. There is a distinct, but under-priced probability that things will look better in 12 months than they do today for UK investors.

Undoubtedly, we will see volatility throughout the year as many earnings statements and outlooks reflect a challenging environment, and markets remain vulnerable to the impact of exogenous shocks. However, this volatility will provide opportunities to own quality UK companies with good management, strong balance sheets with accelerating revenue and earnings momentum at attractive valuations.



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We believe the information provided here is reliable but should not be assumed to be accurate or complete.

All information accurate as at 30 December 2022

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<https://dowgatewealth.co.uk/fund-management-new/>

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