Q2 2020

Standard Life UK Smaller Companies Fund

Aberdeen Standard Investments

Environment

UK equities rose over the quarter but lagged their counterparts in the US, as weaker-than-expected economic data fuelled fears that Britain's recovery from coronavirus could be slow. While shares in smaller UK companies gained strongly, the biggest London-listed stocks, which include many global commodity firms, rose more slowly. News that the UK economy recorded its fastest-ever monthly contraction in March weighed on sentiment. However, a fall in coronavirus deaths, strong May retail sales, easing lockdown restrictions and government stimulus spurred solid quarterly gains.

The Bank of England (BoE) maintained interest rates at 0.1%, which surprised some analysts who believed that the institution would take rates into negative territory. What the bank did do, however, was increase its Asset Purchase Facility by a further £100 billion. This now values the programme at almost £750 billion. Looking ahead, there is a belief that the BoE will still want to avoid taking interest rates lower and focus instead on its quantitative-easing and credit-provision measures.

Activity

We started a new position in GoCo having seen encouraging customer traction with its AutoSave proposition post the LAMB (look after my bills) acquisition. The business is innovating with the launch of its auto-switching service and this could truly transform earnings. Auto switching opens up new customer cohorts (those that didn't switch or were reluctant to do so) and most importantly drives customer stickiness and recurring revenues. We also started a new position in Sumo, a fully end-to-end outsourced games developer. It is a strategic partner to the main players in the gaming sector, creating titles from concept creation to completion and post release. We really like the prospects for the sector and see Sumo a lower risk way of playing the video-gaming theme thanks to revenue visibility and long-term contracts with blue-chip clients. Elsewhere, we took part in a placing for Instem, a market leading IT supplier to the pharma/life sciences industry. Instem is a market leader in its field with high barriers to entry. It has a robust, resilient model, multiple secular growth drivers and a solid strategic and financial position.

Regarding sales, we exited small positions in AJ Bell and Marshalls, as they are FTSE250 constituents and continue to outgrow the mandate. We also reduced holdings in 4Imprint, Churchill China, Johnson Service Group and Midwich. They are all good businesses with strong market positions but we believe recovery will take longer for their end markets. Finally, we trimmed XPP, Liontrust, Avon Rubber, Hilton Foods and Kainos following outperformance.

Portfolio positioning and outlook

It is clear that recessionary times are coming globally. The UK economy will suffer materially and unemployment will be at unprecedented levels. While government pledges to do what it can with VAT cuts and stamp duty changes etc, we are yet to see how demand returns and what shape the recovery will be. This recession will certainly be more Main Street than Wall Street and the effects will be deep and widespread. Poorly capitalised companies and those with limited runway are still at risk of failure as the support ends.

Other risks in the market come from a second wave of infections, the US elections in November and escalating US/China trade wars. Right now there is little evidence so far of a meaningful second wave post the lifting of lockdowns across Asia and Europe. We know a second wave is not impossible but most countries are now better placed to manage it in terms of healthcare capacity and treatment. The news on a vaccine is also promising although that might not be this year. The US elections are close to call, so will become a bigger focus next quarter. As for trade wars, President Trump may well see taking on China as his best chance of winning the election. More generally, we feel that economic cycles will be shorter, sharper and more volatile.

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Strategy

It will be interesting for us to see what new companies we can find that may emerge very differently from the Covid-19 crisis. For some sectors working from home will mean structural change as employees will now demand more flexibility. Companies will need to work hard to find solutions to keep employees engaged and productive. We believe demand will return as confidence returns and, in the fullness of time, aided with a vaccine. Our process has not changed and the pandemic will polarise winners and losers. The quality aspects of our process and long-term investment horizon means that the companies we have in the portfolio are well capitalised with sustainable growth prospects for the long term. Upon any market pullback, we expect our companies to lead the way out.

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Cumulative and Annualised Performance as at 30/06/2020

	3 Months (%)	1 Year (%)	3 Years p.a. (%)	5 Years p.a. (%)
Standard Life UK Smaller Companies	13.2	1.8	7.4	6.0

Discrete annual performance - year to 30/06

	2020 (%)	2019 (%)	2018 (%)	2017 (%)	2016 (%)
Standard Life UK Smaller Companies	1.8	-0.6	22.3	24.5	-12.9

Fund performance has been calculated net of Annual Management Charge.
Source: Aberdeen Standard Investments (Fund)

Past performance is not a guide to future results. The value of investments, and the income from them, can go down as well as up and an investor may get back less than the amount invested. This investment may be affected by changes in currency exchange rates.

Performance

Not owning Halfords detracted from returns. It stayed open through the lockdown and its cycle business continued to perform well. Similarly, not owning Premier Foods proved negative, as it traded well and made progress in reducing debt. Our holding in Hollywood Bowl proved detrimental as it was unable to stay open during lockdown. However, the business remains well capitalised for the next 12 months. Elsewhere, video game developer Team 17 gave back some of its recent strong performance and shares in audio-visual products distributor Midwich drifted on a lack of news.

On the upside, Avon Rubber announced strong interim results as well as material contract wins. Music products group Focusrite also delivered positive results and is experiencing increased demand for its products during lockdown. Tatton Asset Management was another company that released good results, as it maintained inflows and saw a bounce back in assets under management. Finally, Liontrust displayed resilience with modest outflows during the initial stages of the pandemic and positive monthly flows thereafter.

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Important information

Investment involves risk. The value of investments, and the income from them, can go down as well as up and an investor may get back less than the amount invested. Past performance is not a guide to future results. This investment may be affected by changes in currency exchange rates.

Risk factors you should consider before investing:

- The value of an investment can fall as well as rise and is not guaranteed. An investor may get back less than they put in. Past Performance is not a guide to future performance.
- A concentrated portfolio may be more volatile and less liquid than a more broadly diversified one. The fund's investments are concentrated in a particular country or sector.
- The use of derivatives carries the risk of reduced liquidity, substantial loss and increased volatility in adverse market conditions, such as a failure amongst market participants. The use of derivatives may result in the fund being leveraged (where market exposure and thus the potential for loss by the fund exceeds the amount it has invested) and in these market conditions the effect of leverage will be to magnify losses. The fund does not make extensive use of derivatives.
- The fund invests in equity and equity related securities. These are sensitive to variations in the stock markets which can be volatile and change substantially in short periods of time.
- The shares of small and mid-cap companies may be less liquid and more volatile than those of larger companies.

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Standard Life UK Smaller Companies Fund is a Unit Linked Insured fund. The fund invests in the Aberdeen Standard Investments UK Smaller Companies Fund.

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