Why invest in UK Smaller Companies

Why UK small & mid-cap companies?

As investors focused on investing in UK small & mid-cap companies we will naturally and unashamedly always talk about the benefits and attractions of investing in UK smaller companies. Essentially UK smaller companies offer investors exposure to an outperforming area of the market, having delivered returns of +4% more than large caps over time*. Where does this performance come from? It is our view that smaller companies are dynamic and nimble businesses that often demonstrate higher levels of organic growth and operational leverage as their capital light, high returning businesses models adapt quickly to changing market environments and new and emerging industrial trends. These factors have resulted in the smallcap sector consistently demonstrating greater earnings growth than larger peers, which has in turn manifested itself in greater long term returns for shareholders. What’s more, we believe small cap companies are largely under-researched, meaning that many market participants fail to truly understand the growth potential that some of the fantastic businesses can offer to long term investors. This dynamic creates a fruitful environment for us as dedicated small cap managers to add significant alpha for our clients.

Performance and ?

But there’s more to investing in small caps than just the great returns. You see, investing in stocks is more than just red and green numbers flashing on a screen, hoping someone else will be willing to buy it from you for a higher price at a later date. These are businesses and as a shareholder you become one of the owners of said business.

To truly understand this though, we really need to remember what the purpose of the stock market is. Essentially the stock market is a mechanism that connects entrepreneurs requiring capital to start and grow businesses to investors that are willing to provide capital in exchange for a proportion of the ownership of that company... and ultimately participate in the success of that business through dividends and an increasing value of the company over time.

The stock market is a mechanism that connects entrepreneurs requiring capital to start and grow businesses to investors that are willing to provide capital.

Source: BlackRock. Opinions as of 11/02/2022
*Source: Datastream, UK Equity Large Cap Total Return Index and Numis Smaller Companies Index + AIM ex. Investment Trusts Total Return Index as December 1955 to January 2022. The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.
**Why is this more relevant to smaller companies than perhaps large?**

Well, we would argue that the small cap end of the market is a truly active part of the capital markets.

This is where we see the real activity, and the markets serving their fundamental purpose. This is not to say IPOs and capital raises don't occur at the larger end of the market, but it is far less frequent and typically makes less of a difference to the investment case. In some cases the capital required can be for more defensive reasons, to protect a company with falling demand because its industry is going backwards. Conversely in the smallcap space we see many more new and exciting businesses looking to take themselves public to finance expansion and growth, or perhaps raise money for new and exciting acquisitions that enable a company to follow through with its long-term strategy and drive growth for years to come.

Take Auction Technology Group* as an example, an innovative business leading the digitisation within the auction industry which IPO’d in early 2021 with a market cap of around £600m (yes that is small). Then later in the year it came back to shareholders to raise additional capital to finance an acquisition which accelerates its global expansion. Naturally, given we think this is a phenomenal business, we were happy to participate and gave the company additional capital for this deal.

Source: BlackRock. Opinions as of 11/02/2022.

*Reference to the names of each company mentioned in this communication is merely for explaining the investment strategy, and should not be construed as investment advice or investment recommendation of those companies. The company discussed is a top ten holding in the funds noted.

This is just one example of which there are many more and as small cap investors, we are able to provide the much needed growth capital to these businesses and share in their potential success over many years.

The stock market’s ability to match investors with corporates to provide capital is also about more than just an individual company making money. The ability for investors to supply entrepreneurial companies with capital is key to bringing revolutionary ideas to life, making an entrepreneur’s dream become a reality and essentially has had a positive impact on global growth over many decades. What’s more, as an equity investor, you are an owner of a business. You have a seat at the corporate table. Investors are able to hold management teams to account, and through our engagements and votes we can evoke change and best practices in behaviour when it comes to Environmental, Social and Governance (ESG) practices. We have to be clear though, ESG is not about scores from a rating agency. It is about real people, having a real voice. This is a powerful position to be in and as investors we can be a positive contributor to a more sustainable world.

**So, why invest in smaller companies?**

It is active part of the **capital markets** that **provides entrepreneurial businesses the opportunity to drive innovation, aiding sustainable long-term global growth.** And when you find fantastic businesses, as a shareholder you are able to share in some of that long term success along the way.

**How to access the opportunity?**

- **BFM UK Special Situations Fund**
- **BFM UK Smaller Companies Fund**
- **UK Smaller Companies Trust**
Risk Warnings

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. The investor may not get back the amount originally invested.

All investments involve risks and may lose value. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility product or strategy and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

Fund Specific Risks

BFM UK Smaller Companies Fund:

Smaller Companies risk: Shares in smaller companies typically trade in less volume and experience greater price variations than larger companies.

Sector risk: Investment risk is concentrated in specific sectors, countries, currencies or companies. This means the Fund is more sensitive to any localised economic, market, political or regulatory events.

Equity risk: The value of equities and equity-related securities can be affected by daily stock market movements. Other influential factors include political, economic news, company earnings and significant corporate events.

Counterparty Risk: The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss.

Liquidity Risk: Lower liquidity means there are insufficient buyers or sellers to allow the Fund to sell or buy investments readily.

BlackRock Smaller Companies Trust

Sector risk: Investment risk is concentrated in specific sectors, countries, currencies or companies. This means the Fund is more sensitive to any localised economic, market, political or regulatory events. The fund may invest in smaller company shares which can be more unpredictable and less liquid than those of larger company shares.

Derivatives Risk: Derivatives can be used to generate exposure to investments greater than the net asset value of the fund / investment trust. Investment Managers refer to this practice as obtaining market leverage or gearing. As a result, a small positive or negative movement in stock markets will have a larger impact on the value of these derivatives than owning the physical investments. The use of derivatives in this manner may have the effect of increasing the overall risk profile of the Funds.

Investment strategies, such as borrowing, used by the Trust can result in even larger losses suffered when the value of the underlying investments fall.

Counterparty Risk: The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss.
**Liquidity Risk:** The Fund's investments may have low liquidity which often causes the value of these investments to be less predictable. In extreme cases, the Fund may not be able to realise the investment at the latest market price or at a price considered fair.

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