City Asset MANAGEMENT PLC

AIM Valuation Commentary

October 2023

"The Sultan asked Solomon for a Signet motto, that should hold good for Adversity or Prosperity. Solomon gave him, 'THIS ALSO SHALL PASS AWAY.' "

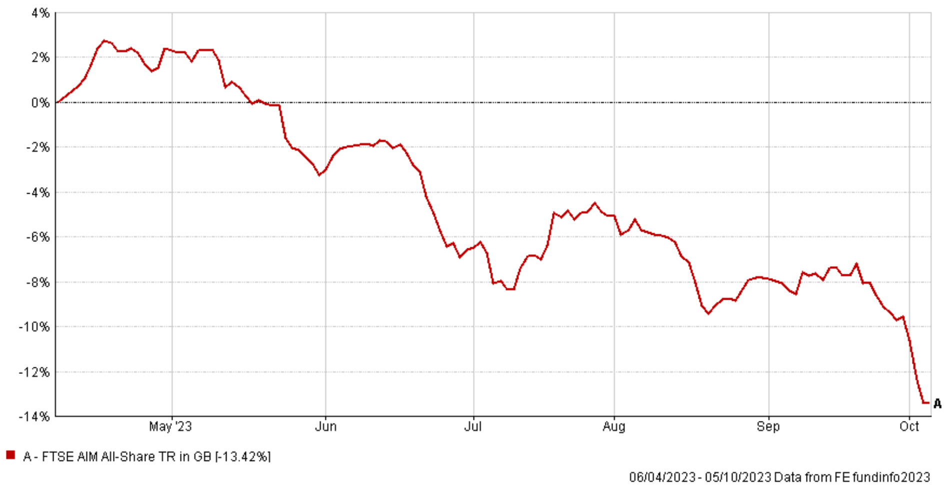
Persian adage, translated by Edward Fitzgerald, 1852

Executive Summary

The AIM index has fallen substantially since the peak in September 2021, but performance in CAM portfolios remains strong. Poor market sentiment continues, and it remains important to think and act as long term investors.

There are signs of change in the future, with the long-term prospect of new money from UK pension funds.

The FTSE AIM All Share Index produced a total return of -13.42% for the six-month period from 6th April 2023 to 5th October 2023, as shown on the graph below.



Over the past 12 months, the FTSE AIM All Share Index generated a total return of -13.31%.

We have now passed the two-year anniversary of the peak of the AIM market. Since that point in September 2021, the AIM All Share index has now fallen circa 45%. This is an enormous move, larger than market falls during the COVID panic. In our 19 years investing in AIM, we have only had one period where the index drawdown was greater than this. The recent falls have placed the AIM All Share Index (not our portfolios!) into negative territory over the past 19 years. In fact, our total returns over that same period are circa 292% after fees.

This clearly leaves us in the situation where investor sentiment towards AIM is terrible; yet, as we used to say during the Great Financial Crisis, the world just keeps turning. Each day companies within our portfolios might supply wound care products to the NHS or manufacture storages boxes for spent nuclear fuels. They may be unblocking hotel drains, testing food products for compliance to government standards or cutting back vegetation for the railway industry. Despite inflation, despite a (possible) recession, despite the war in Ukraine and all the other challenges that exist today, these companies continue to carry out these activities, day in, day out and the resulting profits are very likely to keep flowing.

Hence the quote for this commentary above, which I admit came to me as I fed my newborn child at 5am one morning. I have heard this quotation used for periods of adversity many times. But, when I looked up the origins of this Persian adage (English Literature A level + due diligence in action), I was surprised to find the full quote. The application of the adage to both prosperity and adversity was new to me and leads me to enjoy it even more. It is incredibly apt for investing; periods of outperformance will end, as will periods of underperformance. Nothing is permanent in investing or in life, even companies that have survived over 100 years are re-inventing themselves to ensure their survival.

So, whilst it might feel very little has changed since our last commentary, the impermanent nature of investing suggests otherwise. In our last letter, we discussed private equity funds and larger companies being drawn to AIM due to the valuations on offer. It is now possible that we have discovered another category of investor who may be taking a closer look at AIM companies.

Back in May this year the Chancellor of the Exchequer announced the creation of the Mansion House Compact – an agreement between companies responsible for two thirds of the UK's defined contribution pensions. The compact states that funds will endeavour to invest up to 5% of their assets into private U.K. companies. The idea is that the U.K. pension industry is underweight UK unlisted companies (just 1% of assets). This compares unfavourably to overseas pension funds. Pension assets are ideal to make small allocations to long term growth investments, as they have a very long-time horizon to allow investments to mature.

Intriguingly our understanding is that this 5% allocation includes AIM listed companies, which are considered unlisted due to the nature of the AIM rules. This could lead to a significant wave of new long-term capital coming to AIM. One of our market contacts highlighted that pension funds are weary of diving into venture capital and therefore believe that profitable, established AIM companies are their best option.

This is music to our ears. We believe the assets are in place, the opportunity exists, but we need the investors, and it is likely they will come. But a word of warning, before we all open the champagne; pension funds move very slowly. I am pretty sure a glacier would pass them on the downhill section of a ski run. This is going to take a considerable time to come to fruition, but the Mansion House Compact should be very favourable for the long-term viability of AIM.

Finally, having said that private equity activity was likely to increase last quarter, we have had confirmation of that view. One of our holdings, Instem Plc, has been approached by a private equity firm for a takeover, and it looks likely to occur. We are, as usual, sorry to see it leave. The company provides compliance software to pharmaceutical companies. Its customers include all 20 of the world's largest pharmaceutical companies. Its software ensures that drug research data is collected correctly, monitored, and not tampered with during the research process. When you think about it, Instem is likely to have had a role in protecting us all over the course of our lives. That is quite an achievement for a £170m AIM listed company.

We remain resolute and optimistic about the portfolio companies. This is not blind faith; it is based upon our knowledge of the companies, the activities they undertake and our experience as long-term investors. As noted in our July commentary, current valuations are very attractive and this a very good starting point for long term returns. As is the general apathy of investors towards AIM companies. It means that AIM is much under owned by investors and, should this view change, one could expect meaningful inflows into the market. All of this is likely to lead to a period of higher returns, although of course the timing of such moves is never clear.

So, we remind ourselves:

THIS ALSO SHALL PASS AWAY

And keep focused on owning the best companies we can find.

As ever, should you have any questions regarding your portfolio, or any other matter, please do not hesitate to contact us. Please also contact us if your circumstances have changed in any way.

David Wilcox, Investment Director
David has worked at City Asset Management for over 15 years, where he is Investment Director. His role is to manage clients' portfolios, provide input into investment processes and work with the financial planning team. He also runs the AIM portfolio service and provides input on real estate investments. David has always enjoyed helping our clients secure their financial futures and gets a strong sense of satisfaction in letting clients know they can achieve their goals. Outside of the office, David enjoys hill walking, cycling and martial arts.

Matthew Groom, Investment Director
Matt looks after the day-to-day management of our investment portfolios for private clients, their trusts, pensions and charities. He enjoys trying to understand how economies and corporates operate and using this knowledge to build portfolios that provide the outcomes our clients need. Matt is a Chartered Wealth Manager and has over 30 years' experience in portfolio management, including as Head of Private Clients (London & South East) for Sanlam Private Investments. In his spare time, Matt likes cooking (and eating), fishing and tending the veg patch.

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