February 2018

InFocus

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Standard Life Investments UK Smaller Companies Fund

Key features

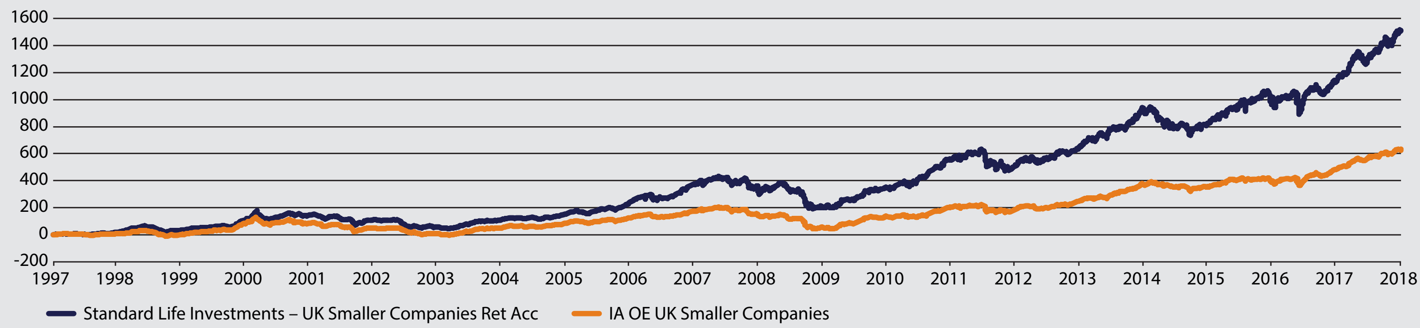
The Adviser Centre Established

UK smaller companies continue to outperform large-caps over the medium to long term

Quality, growth and momentum: the criteria fundamental to our investment process continue to stand us in good stead

Our proven approach leads to a lower-risk means of investing in smaller companies

Performance



Source: FE Analytics. Data to 31/01/2018

	01/01/2017 31/12/2017	01/01/2016 31/12/2016	01/01/2015 31/12/2015	01/01/2014 31/12/2014	01/01/2013 31/12/2013
Standard Life Investments UK Smaller Companies Ret Acc	30.6	3.4	28.2	-8.5	37.7
IA OE UK Smaller Companies	27.2	8.5	14.9	-1.6	37.5

Source: Morningstar Direct, Standard Life Investments – UK Smaller Companies Ret Acc as at 31/01/18

The Fund enjoyed an excellent 12 months, delivering 30.4% to 31 January 2018 against the benchmark return of 24.8%. To the same end date, the Fund has now delivered an annualised return of 14.0% since inception on 6 January 1997.

The track record of outperformance has been achieved thanks to consistent application of our proven bottom-up, stock-picking approach. Through this, we primarily focus on high-quality companies that have strong growth and momentum characteristics. We also look for businesses that have a defendable competitive advantage, good visibility of earnings and the opportunity to sustain profitable growth over the long term. Companies with business models that translate outside the UK are also favoured. Examples of such companies held within the Fund, and notable outperformers in 2017, include First Derivatives, FeverTree, XP Power and Dechra Pharmaceuticals.

Recent trading quotes from these companies (and others) point to a prosperous 2018. FeverTree announced “results will be materially ahead of current market expectations”. Dart Group, which owns airline Jet2, confirmed “gross profits...will be materially exceeded”. Meanwhile, XP Power noted “robust trading” over the early part of the year.

In UK-orientated sectors such as retail and real estate, our portfolio constituents are also showing their class despite domestic challenges. For example, retailers JD Sports Fashion, Motorpoint and Joules are exhibiting good earnings revisions momentum. This is also evident in real estate firms Workspace, Safestore and Big Yellow, with many companies reporting double-digit dividend growth.

Aberdeen Standard Investments

Small-cap investing in a Brexit world

While acknowledging relatively high market valuations and a now mature bull market, it is difficult to accurately forecast how Brexit negotiations will impact equity markets. However, if 2017 is anything to go by, we would recommend against obsessing over macro scenarios and instead concentrate on company fundamentals. Guided by our focus on quality, growth and business momentum, the portfolio is skewed heavily towards non-cyclical companies that can grow against a variety of different economic backdrops and, as such, are more in control of their own fate. Indeed, experience gained over the 21 year lifespan of the Fund indicates that our companies are typically more resilient in the face of challenging market conditions. Thus, driven by micro considerations, we remain confident the Fund will continue to deliver outperformance for investors no matter how the macro picture develops.

Global ambitions

As we highlighted, we tend to favour companies with good international exposure. Some 55% of the portfolio's revenues are derived overseas. A successful UK smaller company often has a business model that initially works in the UK but can then generate success in international markets. Eight out of our top-10 largest holdings have made very significant breakthroughs outside the UK. This should further cushion the blow of any Brexit fallout.

Go big or go home

To illustrate our investment ethos, we would like to highlight three stocks in the portfolio: First Derivatives, Hilton Food Group and RWS.

First Derivatives is a 'big data' firm whose products have applications across numerous sectors, including financial services, media and aerospace. The company is showing great momentum, while earnings growth and upgrades are continuing to come through. Unsurprisingly, it scores well on the Matrix, our in-house proprietary quant tool.

A great catch

Another firm we like is Hilton Food Group. It is primarily involved in meatpacking, with a focus on delivering a premium service to supermarkets. The company operates a high return, low deployment of capital model, which continues to deliver results. Hilton is also branching out, bringing its skills to bear on the fish market thanks to the acquisition of Grimsby-based Seachill. We believe this deal will be earnings accretive going forward.

Not lost in translation

RWS is a market leading support services group, specialising in translation and intellectual property. The company recently bought Czech rival Moravia, and the deal is progressing well. Over the last three years, Moravia delivered 20-25% growth, while RWS is building in an additional 5% for this year. Importantly, Moravia's management team remains in place and the company is operating as a separate unit, ensuring a smooth transition period. In our view, this is a major earnings-enhancing deal, giving RWS a more profitable and diverse sales base. Again, the company has a healthy Matrix score, with earnings upgrades likely.

Final thoughts...

These are just a few of the companies that make us optimistic for 2018. As we have said many times, we are stock pickers at heart – once you find the quality companies, the macro can look after itself. We also have a long-term investment horizon, with a commitment to "running our winners". This ethos has stood the Fund in good stead for over 21 years (and four economic cycles) and should continue to do so as we move through this year and beyond.

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Harry Nimmo
Fund Manager,
Since inception

Aberdeen Standard Investments