



MFM UK PRIMARY OPPORTUNITIES FUND: NIMBLE APPROACH BRINGS SMALL-CAP OPPORTUNITY

One of the biggest benefits of investing with an active fund manager is their ability to be nimble and access opportunities as they arise. A great example is the MFM UK Primary Opportunities fund, that takes advantage of many attractive UK small-caps when these companies are seeking to raise capital for expansion and/or acquisition by issuing new shares in the primary market.

R.C. Brown Investment Management's process provides retail access to these institutional opportunities. It has been doing so since 1990, managing pension mandates for institutional clients, before launching the MFM UK Primary Opportunities fund in 1996. The fund gives retail investors entry to an otherwise hard to access wholesale market. Relationships with investment banks have been nurtured over many years, despite the wide array of opportunities presented to them, their selective approach can only warrant participation in just a few quality stocks. Many of these opportunities are found in the mid and small-caps, that make up 42 of the 70 or so stocks or nearly 50% of the fund. The nature of primary markets leads to investments in companies that have a growth bias, are profitable and pay dividends.

Primary offerings occur regularly. Stocks are purchased at a discount to the prevailing market price. This price advantage creates additional alpha in rising markets and provides protection in the event of a downturn.

We have seen investors shun UK small-caps and indeed some are still wary. The IA reported net outflows in UK Smaller Companies sector in eight of the twelve months between June 2016 & 2017. This was due, in part, to the slow progress in Brexit negotiations with the EU causing continued pressure on Sterling and in part due to the May 2017 election result. Small-cap company performance has been remarkably resilient throughout this period. They have quickly recovered their poise and have since outperformed, returning 31.7% compared with 25.9% for the FTSE 100.*

The UK economy is weathering the Brexit storm well, with no major effect on gross domestic product, employment or wages, with the latter two actually strengthening of late.

Imported inflation caused by the weak pound has caused problems for some smaller companies. But they are often nimble enough

to hedge or adapt their strategies and can defend against or even profit from fluctuations in currency and inflation.

Many of these companies have higher exposure to foreign markets and above average profit margins than some investors assume and are often in highly specialist or niche sectors providing some immunity from economic uncertainty. With the fundamentals remaining sound, this underpins Oliver Brown's view that small-cap stocks still offer good value and so continue to be attractive.

SO WHERE DO R.C. BROWN FIND SMALL-CAP OPPORTUNITIES?

Primary markets are where companies offer institutional investors equity participation through the issuance of new shares. Oliver Brown and his team use their privileged wholesale access and knowledge of primary markets to be at the front of the queue for these events. Unlike distressed businesses in special situation funds, primary opportunity companies are typically healthy and seeking further growth. The team use these events to gain strategic footholds in these businesses, whilst also benefiting from buying these shares at a discount.

The four main areas of opportunity are:

- primary placings – listed companies issue new shares
- secondary placings – sell-down of existing shares by a known seller, e.g. private equity, a forced seller or management
- initial public offerings – when a company goes public
- sub-underwriting and rights issues/ buying the rump, i.e. shares not taken up by existing shareholders

The fund is sector agnostic, has no strict dividend policy, seeking to invest in profitable businesses. Consequently, nearly every stock in the fund is dividend paying.

TOP SMALL-CAP STOCKS

The fund has gained holdings in many valuable small-cap companies via this process.

AIM listed tonic water company Fever-Tree was first purchased at IPO in 2014, it has been the best performing IPO of the last decade. The Company has tapped into the renewed popularity of gin, consistently beating

expectations. It is breaking into the US dark spirits market and if successful, its share price should keep fizzing.

Empiric Student Property, a supplier of high-end student property, recently raised money to purchase assets in London where valuations have softened since the referendum. The Company offers a compelling dividend yield of 5.5%.

Another recent IPO investment is Strix, a global leader in kettle controls, well placed to benefit from growing middle classes in emerging markets. This is a great example of a small company that has a global footprint in a niche area.

Such selections have supported healthy outperformance. According to FE Trustnet, the MFM UK Primary Opportunities fund has returned 75.3% over the five years to 28 August 2017, compared to 69.4% for the IA UK All Companies sector. Over 12 months, it returned 22.9% compared to the sector average of 12.3%, ranking in the top quartile – just as it has for the last three years.**

* Source: FE Trustnet, 24/6/2016-30/6/2017

** Source: FE Trustnet as at 30/08/17

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Fund/Benchmark Name	31/08/2012 to 31/08/2013	31/08/2013 to 31/08/2014	31/08/2014 to 31/08/2015	31/08/2015 to 31/08/2016	31/08/2016 to 31/08/2017
MFM UK Primary Opportunities P Acc	13.59	10.82	-1.27	13.98	23.51
IA UK All Companies	23.55	9.67	1.52	8.85	13.77
FTSE All Share	18.90	10.33	-2.34	11.73	14.33

Source: FE 2017