AMATI AIM IHT PORTFOLIO SERVICE

Review and Outlook
Reasons for Optimism

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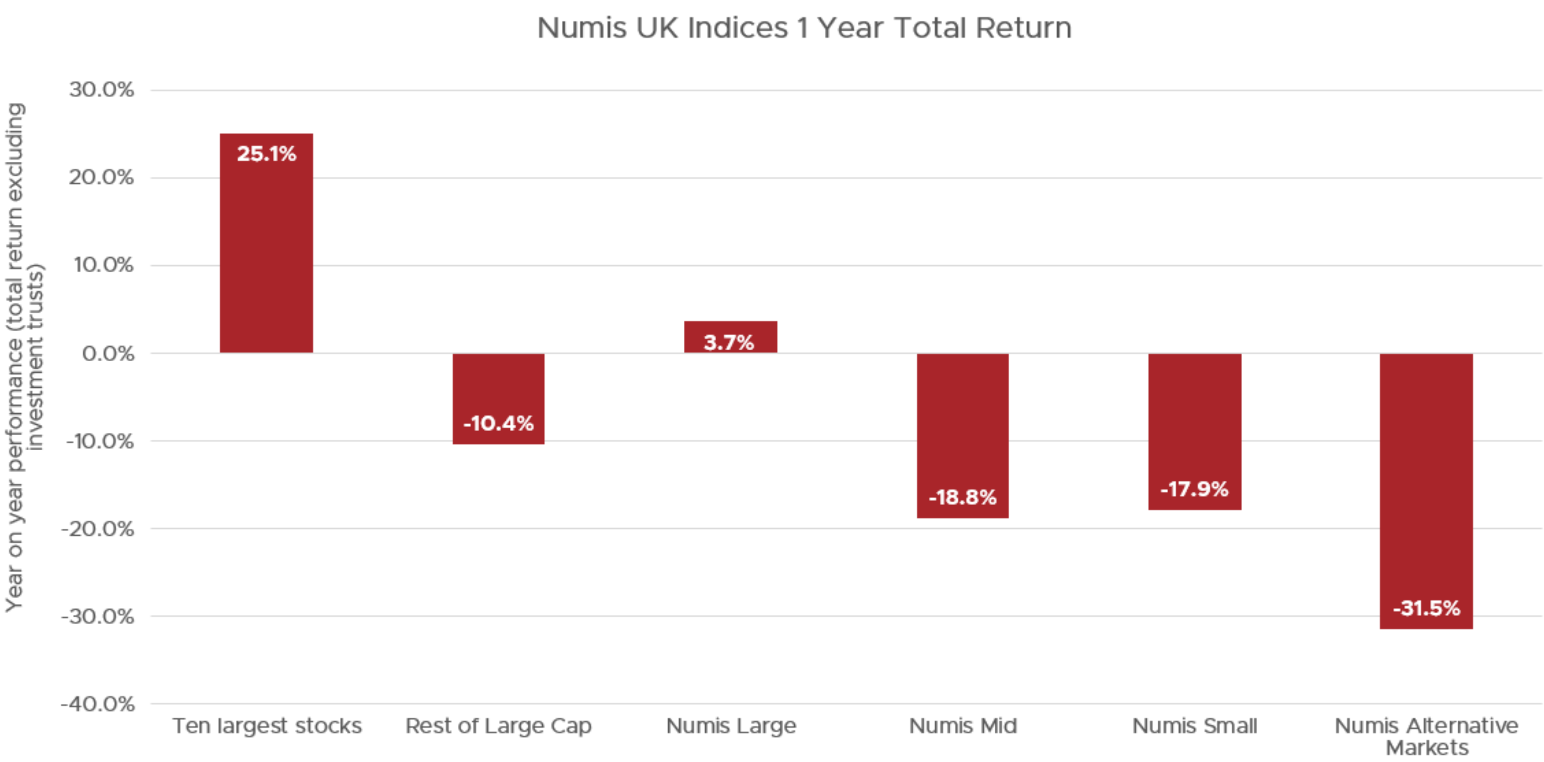
Numis gave their annual review of their indices in January and laid bare the difficult year that investor in the Alternative Investment Market (AIM) had faced. The total return of -31.5% was the worst decline since the Global Financial Crisis (GFC). The Numis Small and MidCap indices also had a tough year and only the Large Cap eked out a positive performance, of +3.7%. Drilling down further into the large cap outturn, it was the ten largest companies that drove the positive performance, delivering over 25% total return. The rest of the large cap index was down 10.1%.

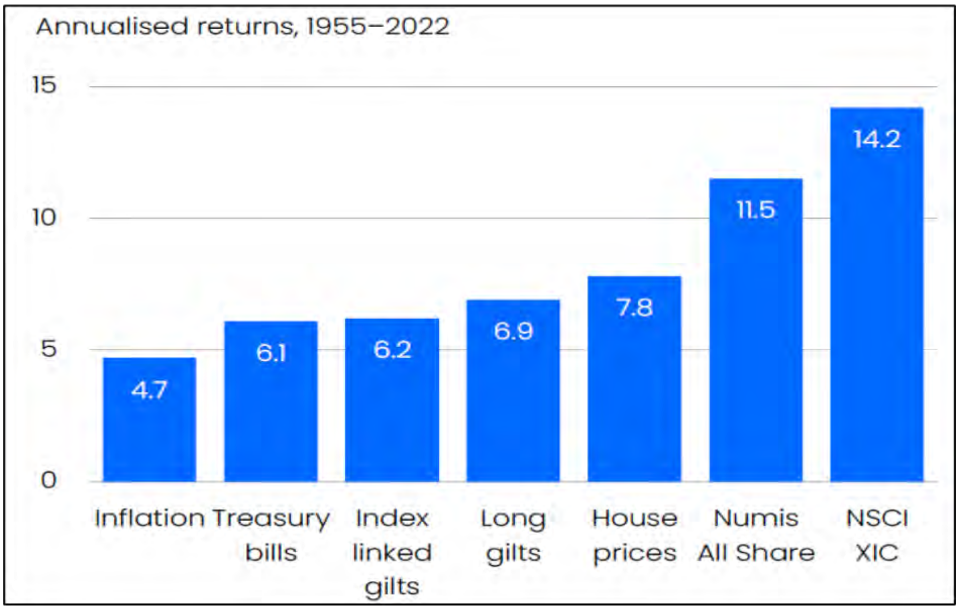
The Amati AIM Portfolio Service invests in AIM-quoted companies that we believe will qualify for Business Property Relief, and against the weak backdrop for 2022 it also had a difficult year, with the model portfolio down 26.3%.

Markets are still reeling from the economic shutdown during the pandemic in early 2020. The enormous fiscal response to it, which led to Central Banks printing money at an extraordinary rate, doubled down on already loose monetary conditions. AIM has over the last few years become the home of media, e-commerce and technology stocks, many of which had a torrid year with weakening end markets and plummeting investor patience.



Source: Amati Global Investors, Numis Securities

Whilst painful, there are reasons for optimism. Over the very long term, Numis analysis shows that smaller companies deliver significant outperformance. They outpace inflation, bonds and larger companies.



Source: Numis Securities

However, with these returns comes a higher risk profile and higher volatility. Drawdowns are more extreme, upward moves too.

Our AIM portfolio service sits alongside our UK Listed Smaller Companies Fund and the Amati AIM VCT, and is managed by the same team. This gives us an excellent breadth of coverage across all the market sectors, and a deep understanding of how our IHT portfolio selections stack up against the wider UK market.

The edge we see in small caps is that often these management teams include founders that have spotted a niche in an industry they understand upside down and inside out. They explore that niche – perhaps first in the UK and then if successful they can start to sell overseas as well. Even if that niche is in a sector that isn't growing much, the company hopefully is able to gain market share through its superior service or pricing.

The long-term performance of smaller companies led us to reflect on the longest standing holdings in the portfolio. Here we take you back to some of the holdings that were in our initial portfolio at the launch of the service. There are three baskets which we classify our holdings in – Family and Management Ownership, Established Technology and Durable/Defensive. Each of these baskets is represented below. Youngs falls into the first category, Gamma Communications and Judges Scientific in the second and Brooks Macdonald the final basket.

Young and Co Brewery

Source: Refinitiv

Established in 1831, it shouldn't come as a surprise that a company that has weathered Spanish Influenza, several spells of inflation and European wars and trade battles, has survived the 2020s, no matter how tumultuous these first years of this decade may have felt to investors.

The Youngs brand is a strong one. Their original Pale Ale was delivered by Shire horses in the 19th century – and the horses were kept onsite at their Ram Brewery until the 1980s. As the demand for bottled beers grew, they opened a bottling plant in the early 1900s. The estate grew, predominantly focused in London and the South East, delivering quality beer, and then food and finally small hotels. The company's freehold ownership is backed by long term debt structures giving the company a solid and robust base from which to grow.

The company floated in 2005. The Young family are still substantial shareholders, which we feel can positively influence the capital allocation decisions of the company and brings with it a prioritisation of dividend payments as a source of income for the family.

Gamma Communications

Source: Refinitiv

Gamma falls into our 'Established Technology' category and illustrates some of the key attributes in companies we think will deliver for shareholders. They have focused on a niche since being founded in 2001: the provision of communication services to SMEs in the UK. As an 'upstart' against British Telecom, they were able to stand out with their sales proposition highlighting their service and advice levels and win market share in a de-regulating market. As the market then transformed and grew, so did Gamma, expanding its range of data products through virtual network operator agreements and becoming an Internet Service Provider. High speed fibre followed. In 2014, Gamma floated on AIM, and has since continued to launch 4G services and cloud services. The company's flagship product now is Horizon Collaborate, a business-only cloud-based unified communications solution designed for internal and external communication needs, including voice and video calls, instant messaging, video conferencing, desktop sharing and document sharing. In 2020, the company launched its Microsoft Teams Direct Routing proposition to allow businesses to make and receive external calls using Microsoft Teams.

Gamma built its business organically and through acquisition. Whilst still at a fairly early stage, the company has taken the model into Europe, and has bought companies in the Netherlands, Germany and Belgium.

Gamma has delivered excellent returns to shareholders over the very long term. However, Gamma has, in common with many more highly valued stocks, given back gains since November 2021, when it became clear that Central Banks would need to respond to rapidly rising inflation by increasing interest rates.

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Judges Scientific

Source: Refinitiv

The company made its first acquisition in 2005 in the arena of scientific instruments. The management identified this sector as an area where the UK was a centre of excellence. As the company states, scientific instrument businesses are underpinned by long-term global drivers, the growth in higher education and 'the industrial drive to optimise everything; and to optimise requires measurement.'

Crucially, the team saw a fragmented sector with over 2000 privately owned companies, ripe for consolidation. They acquired Fire Testing Technology in 2005, and fourteen other businesses have followed. These companies are mostly based in the UK but sell overseas, to a range of markets including universities, manufacturers and regulators. The company may also use debt to acquire, but in seeking cash generative, well-established businesses, will aim to pay down that debt quickly. The acquisition model has clear criteria and parameters, which mean investors can hold management to account.

Brooks Macdonald

Source: Refinitiv

Brooks Macdonald falls into our 'Durable Defensive' category. This means that we expect the company to be able to maintain steady growth through the economic cycle. Brooks Macdonald is a wealth management company which was founded in 1991 and began trading on AIM in 2005. As at the end of 2022, the company had discretionary funds under management of £16.2b.

Wealth is accumulated over decades, and therefore the relationships Brooks has with its clients generally persists and delivers an annuity income.

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The vagaries of market rises and falls are reflected in client portfolios, and the charges Brooks Macdonald can levy on them. This does mean that there is some variance in their earnings line, and to keep up with client and regulatory reporting and suitability requirements continued investment has been required. It is therefore not completely defensive, but we do think that it is durable, whether as a standalone company or potentially part of a larger wealth manager, given that the broader sector is seeing consolidation.

These exceptional companies remain in IHT portfolios to this day because they continue to exhibit the positive attributes which we believe will deliver for shareholders. Our service is actively managed, and the portfolio is a focussed one, with a stock selection process targeted on our three key themes–Family Management and Ownership, Established Technology and Durable/Defensive businesses. Position sizes considered with each company needing to deserve its place within the portfolio.

The Amati AIM IHT Portfolio Service operates on the basis of a Model Portfolio of AIM-quoted stocks, which provides the template for the discretionary management of portfolios held by clients of wealth managers and other intermediaries. The stocks chosen for the Model Portfolio are those that to the best of our knowledge are likely to qualify for Business Property Relief ('BPR'), and as such could potentially provide up to 100% inheritance tax relief after a holding period of two years subject to the final determination of HMRC). Dividends received from portfolio companies are re-invested.

Risk Warning

Investment in smaller companies can be higher risk than investment in well-established blue chip companies. Portfolios investing significantly in smaller companies can be subject to more volatility due to the limited marketability of the underlying asset.

Amati, in its capacity as discretionary investment manager, will select stocks which it expects to qualify for BPR, but it cannot guarantee 100% of the portfolio will be exempt from IHT after 2 years, nor that the qualification rules as set out by HMRC will not change in future in a way that affects the status of individual holdings.

Any investment in equities is subject to risk, and smaller companies can Involve more risk than larger companies. Illiquidity means that buying and selling portfolio holdings may take time, and in a worst case scenario companies could be delisted from AIM making them very difficult to deal in. This investment product places your capital at risk and you may not get back the full amount invested. Tax treatment may be subject to change and depends on the Individual circumstances of each investor. The availability of tax reliefs also depends on the investee companies maintaining their qualifying status.

Neither past performance nor forecasts are reliable indicators of future results and should not be relied upon. Unquoted or smaller company shares listed on AIM are likely to have higher volatility and liquidity risks than other types of shares quoted on the London Stock Exchange Official List. This content is not intended to constitute investment, tax or legal advice. Investors should consult their professional financial adviser to determine the suitability of this investment before they proceed.

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