WHITMAN
ASSET MANAGEMENT

NEWSLETTER Q3 2020

The recovery in stock prices which started at the end of March continued into the third quarter. Our UK Smaller Companies Growth strategy[1] returned +10.3% over the quarter versus its benchmark, the NSC plus AIM Total Return Index[2], which returned +6.4%. Our AIM IHT strategy[1] returned +6.8% over the quarter versus its benchmark, the Numis Alternative Markets Index[2], which returned +8.5%.

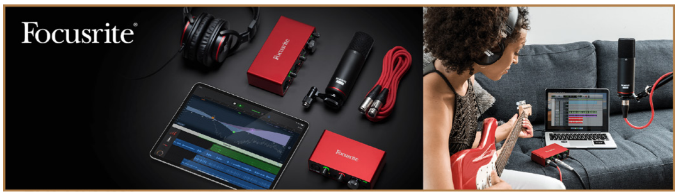
We remain optimistic about the prospects for our companies and for the smaller companies asset class in general. However, careful stock selection is more important than ever as many industries are challenged as never before, being pincered between the constraints of Covid-19 and changing spending patterns. Specifically, sectors such as commercial property (retail, leisure and office), travel (bus, train and airline), hotel and leisure (pubs, clubs, theatres and cinemas), events (sporting, educational and entertainment) and physical retailing are all sectors that have been fundamentally challenged by the Covid-19 virus restrictions.

Initially it was consensus thinking that these restrictions would be temporary in nature, but increasingly business leaders are having to factor in that current changes in spending patterns may be reasonably permanent. For example, office workers will be allowed more flexibility in choosing whether to work at home or commute into the office and executives from international companies will be increasingly attracted to a 'Zoom' call in preference to international travel.

Many management teams are being severely tested but equally some are basking in the sunshine of digitalisation, working from home, educating from home, and entertaining from home. Equally, the favourable long term dynamics of the savings and pension industry and the alternative energy space, remain as compelling as ever. Many of the companies benefitting most from these dynamics lie in the small company sector. It is hardly surprising therefore that there has been a major divergence between the large and small cap indices this year, with the FTSE 100 Index[3] showing a total return of -20.2% and the Numis Smaller Companies plus AIM Total Return Index[2] returning -11.3%, to the end of September.

The overall valuations for smaller companies remain reasonable in our view, with both the Numis Smaller Companies plus AIM Index and FTSE 100 trading on 14x forward earnings[4]. This is despite the considerably more attractive long-term growth rate for the former.

There are, of course, macro and political uncertainties on the horizon as there always are. A forthcoming steep rise in UK unemployment, Brexit uncertainties and the US Election can be added to the Covid-19 issues. We have tried to consider these issues in our stock selection and in the recent results season the majority of our holdings have matched or exceeded profit expectations.



Focusrite, a new holding for us, would be an example of this. The company has a market size of approximately £500m and is a global leader in the audio recording industry. Their core product, the Scarlett interface, enables musicians, podcasters, and bloggers to convert content from analogue into digital format. The digital format can be easily manipulated, transferred, or stored in the Cloud. In July they announced the increase in demand for Focusrite products had been:

'pronounced during lockdown and we are grateful that so many people around the world are choosing our solution for their creative needs.'

High cash generation is a key feature of the business model and the balance sheet will be debt free by the end of the year. There is an impressive M&A track record carried out by a very driven management team who are well incentivised with significant equity ownership. We see strong growth characteristics for this company for many years to come as they continue to expand internationally and innovate with new product releases.

To make room for stocks such as Focusrite we have sold down some long-standing holdings, including Restore and James Halstead. These have been stalwart servants in client portfolios for many years and have been very good performers over the long term but they have new challenges under current conditions.

As Bob Dylan wrote back in 1964 (but it is just as applicable today):

The Times they are a-Changin'

Come senators, congressman
Please heed the call
Don't stand in the doorway
Don't block up the hall
For he that gets hurt
Will be he who has stalled
There's a battle outside that is ragin'
It'll soon shake your windows and rattle your walls
For the times they are a-changing.

Bob Dylan 1964

Christopher Pease
October 2020

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Risk Warnings

GENERAL AIM RISK WARNING

An AIM or Small Cap Portfolio should be regarded as a higher risk, long-term investment, suitable only for investors with financial security that is independent to any investment being made under these Terms. We strongly recommend that you seek professional advice before you ask us to manage your AIM or Small Cap Portfolio for you.

The investments that will be held in the AIM and Small Cap Portfolio are likely to be smaller UK companies. The AIM Portfolio should qualify for the maximum business relief after two years. Such investments will inevitably involve higher risk and may be difficult or even impossible to realise in a reasonable timescale or at an acceptable price. Investors and potential investors should be mindful of the need to appropriately diversify their assets and higher risk investments should not form a significant part of any portfolio.

PAST PERFORMANCE WARNING

Past Performance is no guide to future performance and there is no guarantee that your AIM or Small Cap Portfolio's objective will be achieved. We can make no guarantee of investment performance or the level of capital gains or income that will be generated by your AIM or Small Cap Portfolio. The value of Qualifying Investments and the income derived from them may go down as well as up and you may not get back the full amount invested.

LIQUIDITY RISK WARNING

Please note that Qualifying Investments can carry a higher degree of risk than investing in more liquid shares of larger companies. The share prices of AIM and Small Cap listed investments are generally more volatile than larger market capitalisation shares listed on the London Stock Exchange main market. There may be a wide spread between buying and selling prices for AIM and Small Cap listed shares. If you have to sell these shares immediately you may not get back the full amount invested, due to the wide spread. The value of your investments may decline and there is a risk that this may outweigh any saving made regarding the IHT relief applicable to the AIM Portfolio. You should be aware that the Qualifying Investments in your AIM or Small Cap Portfolio may be classified under FCA Rules as 'not readily realisable' (these are investments in which the market is limited or could become so: they can be difficult to deal in or obtain reliable information about their value).

TAX LEGISLATION WARNING

Rates of tax, tax benefits and allowances are based on current legislation and HMRC practice. These may change from time to time and are not guaranteed. Investment in the AIM Portfolio may not be suitable for all investors. You are recommended to seek specialist independent tax and financial advice before deciding to subscribe to the AIM Portfolio Service. This AIM Portfolio Service has been designed with UK-resident taxpayers in mind. If you are not resident or ordinarily resident in the UK for tax purposes, it may not be appropriate or advantageous for you to subscribe to this AIM Portfolio Service.

QUALIFYING INVESTMENTS WARNING

AIM Portfolio investments may cease to qualify for inheritance tax exemption. In this case, the relief available on that particular investment will be lost. In some instances, investments in particular companies will be sold if we believe that the investment rationale outweighs the tax. If the investments lose their qualifying status then investors may not receive any tax benefits at all from making such investments. Qualifying investment status is subject to change without notice and tax benefits are not guaranteed.

Sources: [1]Whitman Model Portfolios Sept 2020
[2]Numis Indices Sept 2020
[3]FTSE data
[4]Peel Hunt Oct 2020