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BY MARTEN & CO

INVESTOR

BlackRock Throgmorton – AGM update

Investment companies | Flash note | 20 March 2024

Throgmorton's fuse is lit

In yesterday's BlackRock Throgmorton (THRG) annual general meeting, manager Dan Whitestone outlined the significant potential for a surge in UK equities, with small and mid-caps outperforming large caps by a sizeable margin, as the macroeconomic outlook in the UK improves.

Dan highlighted that UK companies' share prices have become increasingly detached from their earnings potential. A combination of political uncertainty thanks to the forthcoming elections, sticky interest rates, strength in overseas stock markets (in particular in a handful of big AI-related US tech names), and consistent outflows of investments in UK-focused funds has weighed on valuations.

Dan believes that the UK small and mid-cap sector is at one of its most attractive entry points in recent memory, based on current share prices. We observe that Dan is not alone in this view, with the UK market being subject to elevated levels of takeover activity.

Despite this backdrop, Dan has still been able to demonstrate the merits of good stock picking, having generated strong long-term out outperformance versus his peers and benchmark.

THRG's board has substantially increased its share buyback activity. Nonetheless, THRG's discount remains at a historically wide level and may offer investors an attractive way to capitalise on a possible near-term bounce in UK companies.

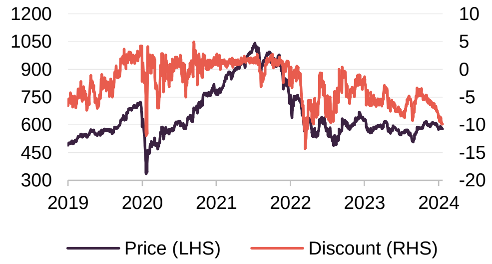
12 months ended	Share price TR (%)	NAV total return (%)	Peer group avg NAV TR (%)	Numis Sm Co.s plus AIM, ex IC (%)
29/02/2020	22.2	16.9	9.8	1.4
26/02/2021	31.5	27.6	16.6	24.9
28/02/2022	0.7	2.8	5.7	1.5
28/02/2023	(15.5)	(15.4)	(5.4)	(7.5)
29/02/2024	(6.4)	1.0	(3.3)	(5.8)

Source: Morningstar, Marten & Co.

Sector	UK smaller companies
Ticker	**THRG LN**
Base currency	**GBP**
Price	**578.0p**
NAV	**641.0p**
Premium/(discount)	**(9.8%)**
Yield	**2.6%**

Share price and discount

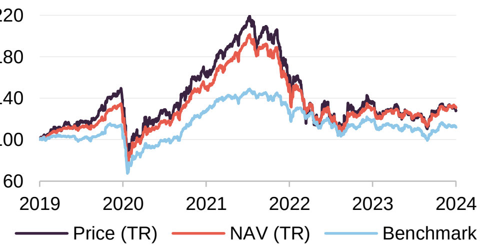
Time period 28/02/2019 to 20/03/2024



Source: Morningstar, Marten & Co.

Performance over five years

Time period 28/02/2019 to 29/02/2024



Source: Morningstar, Marten & Co.

UK equities markets are ripe for recovery

The UK equity market trades at a wide disconnect from its earnings potential

Following what has been a torrid time for the relative performance of UK equity markets when compared to its developed peers, with the share price performance of UK companies having become increasingly detached from their earnings potential, Dan Whitestone believes that UK markets are ripe for a sharp bounce and feels that could happen very quickly.

Dan's investment approach favours high-growth, high-quality companies. Nevertheless, he says that the earnings figures for his holdings have often exceeded his own forecasts during the last year, vindicating his increasing bullishness around THRG's prospects.

Faling inflation and a forthcoming election may be catalysts for a UK rebound

Dan has identified two potential near-term catalysts for a rebound in UK equities, with small cap companies being amongst the strongest beneficiaries. The first is a return to target UK inflation, and the scope that should create for interest rate cuts, and the second is the forthcoming election.

Estimates from the Office for Budget Responsibility indicate that UK inflation will fall further to an average of 2.2% over 2024 and 1.5% in 2025, bringing it below the 2% target of the Bank of England. This, combined with sub 1% GDP growth expectations for the UK, may place sufficient pressure on the Bank of England to cut interest rates, stimulating a recovery. At 3.4%, the latest UK inflation figure (announced today) came in below expectations, adding further pressure on the Bank of England.

Lower inflation, and by extension interest rate expectations, could be very positive for THRG, as it was caught up on the growth-stock selloff of late 2021 and 2022, a result of rising interest rate expectations.

While there appears to be little uncertainty about the outcome of the general election in the UK, policy announcements from the Labour leadership suggest it will be following a fairly centrist and fiscally responsible approach. This suggests that, after an extended period where political infighting, numerous policy missteps and U-turns have provided an excuse to avoid the UK, the election will give way to a period with much reduced political risk.

UK businesses and consumers remain robust

Even without a catalyst for a reversal, Dan believes that much of the negative sentiment around the UK economy is overstated. He notes that UK business confidence has seen a remarkable rebound over 2023, with the Lloyds Bank Business barometer (a metric that tracks business confidence) having reported a net positive of 35%, well above its 25-year average of 28% (a period which filters out much of the recent economic pain).

The UK consumer is also showing signs of sustained strength, with the average UK household income increasing almost consistently over 2023, topping out at a 10% year-on-year increase (based on weekly sampling).

Further evidence of the relative attractiveness of UK valuations is provided by the upsurge of merger and acquisition activity over 2022 and 2023, as larger companies and private equity have pounced on undervalued UK stocks. THRG's recent performance has already benefitted from the takeover of some of its holdings, with Dechra Pharmaceuticals being one such example.

Meanwhile, UK companies are also net buyers of their own stock, with 13% of large UK companies buying back at least 5% of their shares over 2023, according to research by Schroders. This compares with 9% in the US, which has often been viewed as the major market for buyback activity. Not only have these activities been supportive of THRG's NAV but they also serve as solid evidence of the opportunity presented by UK companies, given that its current valuations are attracting strategic buyers.

THRG has generated both short and long-term outperformance thanks to Dan's stock picking skill

The market has already started to move

In retrospect, it looks as though the turning point for the market's recovery may have been the growing realisation in October 2023 that interest rates had peaked. While it has not been a smooth ride since, thanks to a couple of disappointing inflation figures, we have already begun to see a reversal of previous trends, with THRG generating sector and benchmark beating performance since then and over the last 12 months, as can be seen in Figure 1. We note that despite the magnitude of the drawdown during 2022, THRG's long-term performance remains sufficiently good to place it well ahead of its benchmark and peers over longer time periods.

Figure 1: Cumulative total return performance over periods ending 29 February 2024

	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
BlackRock Throgmorton share price	1.6	5.4	(6.4)	(20.3)	28.1
BlackRock Throgmorton NAV	7.1	6.5	1.0	(12.1)	31.0
Benchmark1	4.5	1.7	(5.8)	(11.6)	11.9
Peer group median NAV2	6.3	5.8	(0.5)	(0.3)	19.8

Source: Morningstar, Marten & Co. 1: Benchmark: Numis Smaller Companies plus AIM (excluding Investment Companies) Index. 2: Peer group based on the 13 closest competitors within the AIC UK Smaller Companies sector

THRG's recovery aligns with Dan's notion that its underperformance during 2022 was primarily the result of the rise in interest rates, rather than structural weaknesses in his companies.

While Dan believes that there are clear near-term tailwinds helping THRG, he has positioned the portfolio to benefit from long-term structural growth trends that he expects will drive the trust's performance. The majority of THRG's long-term outperformance (relative to its benchmark) should always be expected to come from successful stock selection and not from gaming the macroeconomic environment.

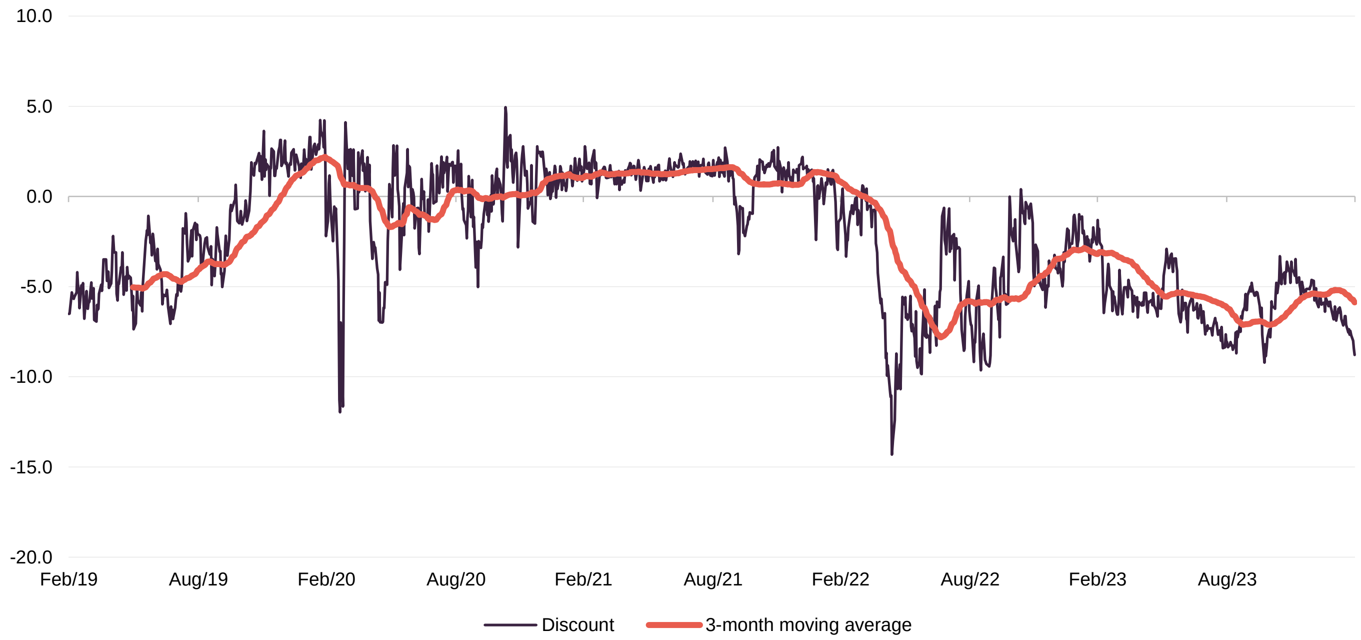
Anomalous discount, attractive entry point?

THRG's board has been proactive in buying back shares

THRG's board has substantially increased its share buy-back activity since the start of 2023. Over the last 12 months THRG's board has repurchased c.7% of the trust's outstanding shares. Yet despite this effort, THRG's discount has not been immune to the general weakness of investment company discounts, trading on a 9.9% discount currently.

THRG's discount has a 12-month z-score of -2.67 (a score below -2 implies that its discount is more than 2 standard deviations below its 12-month average, a wide level by statistical standards).

Figure 2: THRG discount over five years to 29 February 2024



Source: Morningstar, Marten & Co

We believe that this wide discount, combined with the near-term opportunities in the UK small cap equity market and THRG's historic out-performance, makes the trust a compelling opportunity for those looking to capitalise on a possible bounce in UK equity markets.

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