EDISON

Henderson Smaller Companies Investment Trust

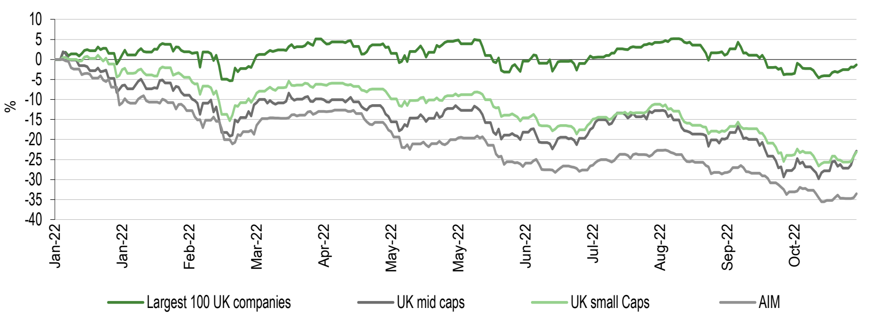
No light at the end of the tunnel yet

Investment trusts
UK smaller companies

8 November 2022

In our Henderson Smaller Companies Investment Trust (HSL) initiation note in June, we highlighted the strong features the company brings to investment in UK small and mid caps, notably an experienced manager and team, an efficacious process and competitive fees. So far, 2022 has been the second most difficult year that the lead manager, Neil Hermon, has experienced in his near 20-year tenure at HSL and in his 33-year small-cap investing career overall (the most difficult being during the global financial crisis). The fund's weak showing in 2022 might have affected its three- and five-year performance, but it has not derailed HSL's 2.8% net annual outperformance of the index over Hermon's tenure. In this adverse investment environment investors can be reassured by HSL's experienced management team and established investment process, honed over many years and through multiple investment cycles.

2022 has been a grim time for investing in UK small and mid caps



Source: Refinitiv, Edison Investment Research. Note: Total returns in sterling.

Why consider HSL now?

UK smaller companies have had a prolonged period of underperformance versus larger UK companies and have been especially out of favour in 2022 as investors have become increasingly risk averse, rising interest rates have affected the valuations of long duration growth assets and sentiment towards the UK has deteriorated with political and economic volatility. Taking a step back, the historically superior rates of growth that UK small caps have delivered, together with the inefficiency of the market, has provided investors with compelling returns (even adjusting for the additional risk) when compared with larger UK companies. Their key attributes of nimbleness, disruptive technology and in many cases robust financial strength endure even in the current environment and provide the foundations for long-term future growth. In addition, the current valuation dispersion on offer between UK small caps, large caps and overseas markets provides investors with a suitable investment time horizon and attitude to risk with an opportunity to buy UK small-cap growth at historically depressed levels.

Price	**793.0p**
Market cap	**£592.4m**
Total assets	**£741.1m**

NAV*	885.0p
Share discount to NAV	10.4%

*Including income. at 7 November 2022.

Yield	3.1%
Shares in issue	74.7m
Code/ISIN	HSL/GB0009065060
Primary exchange	LSE
AIC sector	UK Smaller Companies
Financial year end	31 May

52-week high/low*	1,254.0p	680.0p
NAV* high/low	1,374.9p	781.3p

*Including income.

Gearing

Net gearing at 2 Nov 2022	12%

Fund objective

Henderson Smaller Companies Investment Trust (HSL) aims to maximise shareholders' total returns (capital and income) by investing in smaller companies that are quoted in the United Kingdom. The fund's benchmark is the Numis Smaller Companies (excluding investment companies) Index, which is the bottom 10% of the UK stock market by market cap (up to c £1.5bn market cap). In addition, the fund invests in the Alternative Investment Market (AIM).

Bull points

- In adverse economic conditions experienced management gives comfort.
- There has been no diversion away from the long-term successful investment process.
- Valuations for UK assets arguably offer significant value.

Bear points

- Portfolio not immune to diminishing investor demand for UK small caps.
- Weak investor sentiment towards UK small caps could persist for some time yet and through 2023.
- Material use of gearing adds volatility.

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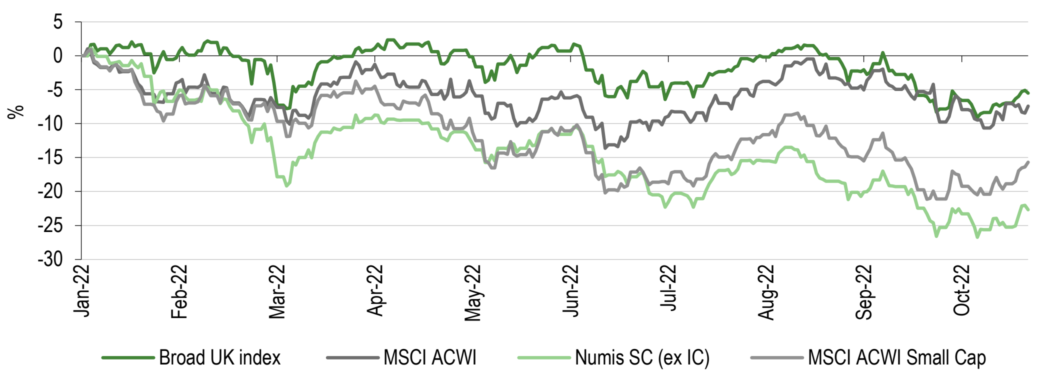
More volatility likely through 2023

2022 has seen considerable equity and bond market volatility caused by soaring inflation, the potential trajectory for interest rates and the Chinese government's zero-COVID-19 policies, which are all contributing to slowing global economic growth. In addition, the ongoing geopolitical impact of the war in Ukraine and the UK political situation have added an unwelcome source of uncertainty for the UK economy and sterling in particular. COVID-19 continues to be a headwind as the ongoing supply chain disruption has negatively affected companies within HSL's portfolio, as has the increase in energy and gas prices, which has been an upward pressure on input prices, denting margins. In this environment, HSL's management is focused on investing in companies with pricing power.

What might be a catalyst for an improvement of fortunes in the portfolio and for small caps more generally? A resolution to the Ukrainian war does not look likely in the near term, but an easing of energy prices would help investor sentiment to risk assets, and there has been some recent rolling over of energy, freight and raw material costs. Linked to this, if investors were to gain some transparency on the level at which inflation and interest rates will peak, this would go a long way to giving small-cap growth assets a lift. However, Hermon acknowledges that near-term catalysts for a re-rating of small-cap growth looks unlikely. While macroeconomic headwinds are likely to persist in 2023, valuations for the asset class are far more attractive, which gives the manager some cause for cautious optimism for potential returns next year. In the longer term, if inflation (and interest rates) end up being structurally higher, then this calls into question the valuation multiples that investors should be paying for growth assets such as smaller companies.

Exhibit 1: UK small and mid caps have underperformed their global peers and large-cap comparators throughout 2022



Source: Morningstar. Note: All data in pounds sterling.

While UK smaller companies face challenges, in many respects this is business as usual. However, in these difficult times investors should not lose sight of the long-term structural tailwinds that support investing in smaller companies, which include faster organic growth, more agility in the face of change, being a source of new disruptive technology and that they benefit from mergers and acquisitions (M&A). They are also under covered by sell-side analysts, with Janus Henderson Investors (JHI) highlighting that, on average, a stock that is between £500m and £1bn in market cap (HSL average market cap c £900m) is covered by seven sell-side analysts compared with a stock that is £10bn+ with 24 analysts. For those looking for opportunities at the smaller end of the UK market, then mispriced opportunities are naturally more prevalent, especially when it is an experienced team scrutinising this opportunity set. The mix of industries that UK small caps offer over UK large caps is also a factor that has provided long-term support but shorter-term weakness. The high weighting to growth sectors such as technology, which is 8.2% in the Numis Smaller Companies Index (excluding investment companies), compares with 0.87% in the largest 100 UK companies (30 September 2022). Technology has seen a significant derating in 2022, which has contributed to small companies' underperformance this year.

Fund profile: Mid-cap bias

HSL is managed by Neil Hermon with the assistance of his team at JHI and aims to maximise shareholder total returns by investing in high-quality, growing smaller companies in the UK. The benchmark is the Numis Smaller Companies Index (excluding investment companies), which is the bottom 10% of the UK Main Market by value, consisting of around 400 companies. The managers can also invest in AIM-listed shares, which increases the investment opportunity set by a further c 800 companies. The team generally avoids stocks with a market cap of less than £150m, which reduces the investable universe and helps mitigate liquidity concerns. New investments are limited to the Numis or AIM indices, and the managers are not afraid of running their winners and will continue to hold positions, when deemed appropriate, as they grow out of either index, although they will sell within six months if a stock becomes one of the largest 100 UK companies. Stock positions are limited to ±4% relative to the benchmark with sector positions ±10% versus the index. Equities can account for 80–100% of total gross assets with fixed income or cash limited to a range of 0–20%. No more than 5% of the gross assets of HSL can be invested in a single holding or into more than 10% of an investee company at the time of purchase (in exceptional circumstances and with board approval this may be increased to 10% and 20% respectively). No more than 15% of HSL's portfolio will be invested into other listed investment trusts and net gearing is limited to a maximum of 30% of shareholders' funds.

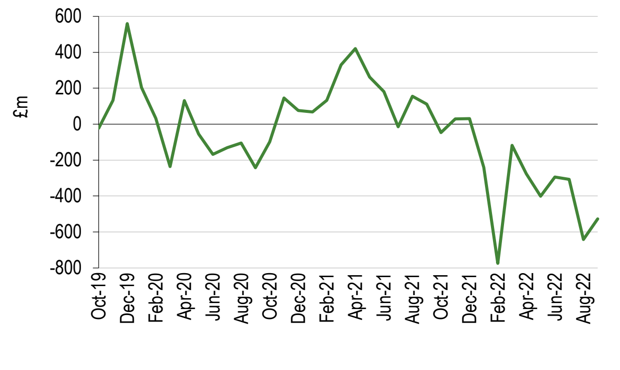
HSL has a notable record on income

HSL has a record of increasing its dividends for 19 consecutive years with a compound average growth rate (CAGR) of 23.9% (2003–21) versus the broad UK market dividend CAGR of 4.1% over the same period. Portfolio dividend income has made a recovery since the start of the COVID-19 pandemic when it fell to c £10m from the pre-COVID-19 level of c £19m. Portfolio income has now recovered to c £23m, which is testament to the confidence that company management has in its future earnings. Confidence is also signified by the increase in buybacks as a means of returning cash to investors. With a current dividend yield of 3.1%, HSL provides a modest dividend premium over AIC peers and is a useful contributor to total investor returns.

UK small cap is deeply unloved by investors

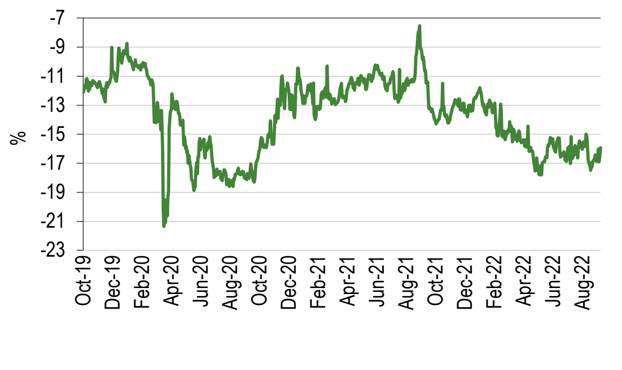
In a 'risk-off' environment, investors sell or reduce volatile assets such as equities and especially smaller companies, which are perceived as less financially robust and more susceptible to market shocks than large caps. In 2022 to date, UK smaller companies (and especially those listed on AIM) have significantly underperformed larger UK companies, which may be regarded as having more dependable and internationally derived earnings. Smaller companies traditionally derive more of their sales domestically and as at 31 December 2021 HSL's portfolio earned 52% of its end-market sales in aggregate from the UK. Both fund flows and discounts on UK smaller company investment trusts have reflected diminishing investor demand for these assets (Exhibits 2 and 3).

Exhibit 2: Demand for UK small- and mid-cap funds has been weak



Source: Morningstar. Note: Estimated monthly flows into UK small and mid-cap fund.

Exhibit 3: Discounts widening on the AIC UK smaller companies sector



Source: Morningstar. Note: Unweighted average discount of the AIC UK smaller companies peer group.

UK small caps are now pricing in significant investor pessimism. According to JHI, at 30 September the UK equity market as a whole was trading on a forward P/E of 8.5x (which compares to the 10- and 20-year historical average of c 13x), a significant discount to other regional markets. HSL has a quality bias to its process and trades on 9x, which is a slight premium to the fund's Numis Smaller Companies Index (excluding investment companies) benchmark in terms of 12-month forward forecast P/E. HSL, however, has higher forecast growth than the index.

Despite the range of headwinds facing smaller company investing, there are reasons for optimism, with corporate profitability being robust and strong balance sheets in aggregate. In addition, there is selective support for UK smaller companies from trade buyers (both in the UK and overseas), while many companies are increasing dividends and share buybacks, while director buying has increased, which validates the value on offer. Given the more expensive cost of debt, it remains to be seen how active private equity investors will be. However, UK mid- and small caps are very much on the radar for acquisitions, especially given the fall in the value of sterling versus the dollar. In 2022, according to JHI and BNP Paribas, there were 14 bids made to UK smaller companies (mostly from overseas trade buyers) including for Brewin Dolphin and Micro Focus.

From a technical perspective, the manager points to the current 12-month forward P/E on the largest 350 UK companies (at 7 October) being equal to the 12-month forward free cash flow yield. Since 2006 this has occurred on four occasions (2008, 2011, 2020 and 2022). Small-cap returns after each of these periods were strong, averaging 37.5% in the subsequent years (2009, 2012 and 2021) versus 20.2% for the UK market overall. Hermon is keen to highlight that the portfolio is trading well overall despite the powerful headwinds evident, with the 12-month forecast earnings growth for the top 20 unweighted positions at 20 October of c 13%, however, the share prices of these positions have seen an average fall of c 30% through 2022. The cause of this negative movement was the average P/E multiple derating by 38%. The conclusion that may be inferred is that in the current economic environment, investors are less willing to pay high multiples for future growth. It remains to be seen if and when that sentiment may reverse.

Positioning, transactions and turnover

The top five sector overweights at the end of September were software and computer services, electronic and electrical equipment, media, industrial support services and household goods and home construction. Key names within these areas include Learning Technologies Group (HR services and training), Oxford Instruments (technology tools for industry and scientific research), XP Power (power solutions for a range of industries), Ascential (commercial data analytics), Serco (outsourcing services), DFS (sofas and soft furnishings) and Bellway (UK house building). The largest underweights were travel and leisure, food producers, banks, real estate, investment trusts and non-life insurance, although there are positions in these areas including Mitchells & Butlers (pubs and restaurants), Savills (real estate services) and Workspace (flexible London office space). Sector weightings are a result of the stocks selected, rather than as a conscious top-down driven decision. However, the sectors that are overweight tend to exhibit growth characteristics that fit in with the process, which seeks out fast-growing companies at the right price.

Exhibit 4: Portfolio sector exposure vs Numis Smaller Companies (% unless stated)

	Portfolio end-September 2022	Portfolio end-September 2021	Change (pp)	Index weight	Active weight vs index (pp)
Industrials	33.0	29.7	3.3	27.1	5.9
Consumer discretionary	20.9	26.2	(5.3)	15.4	5.5
Technology	14.9	13.3	1.6	8.2	6.7
Financials	14.1	14.4	(0.3)	17.8	(3.7)
Energy	5.6	2.7	2.9	8.1	(2.5)
Real estate	5.5	3.7	1.8	6.5	(1.0)
Basic materials	2.9	3.7	(0.8)	5.4	(2.6)
Healthcare	1.3	4.6	(3.3)	2.4	(1.1)
Telecommunications	1.7	1.7	0.0	1.4	0.3
Consumer staples	0.0	0.0	0.0	4.6	(4.6)
Utilities	0.0	0.0	0.0	3.2	(3.2)

Source: HSL, Edison Investment Research

Transactions: Focusing on the value in the existing portfolio

Typically, the manager only makes 15–20 new purchases a year and has an average holding period within the portfolio of more than five years (Exhibit 8). In 2022, to the end of September, only six new holdings were made. The rationale was that the manager believes there to be significant value within the portfolio itself, and so the focus was on topping up existing holdings (which in hindsight in a falling market proved to be an error) and backing the conviction within the portfolio rather than adding new positions. Consequently, the portfolio has gone from around 110 holdings to 100, with sales being made where the investment thesis did not play out or the initial analysis proved to be flawed.

Exhibit 5: Top 10 holdings (at 30 September 2022)

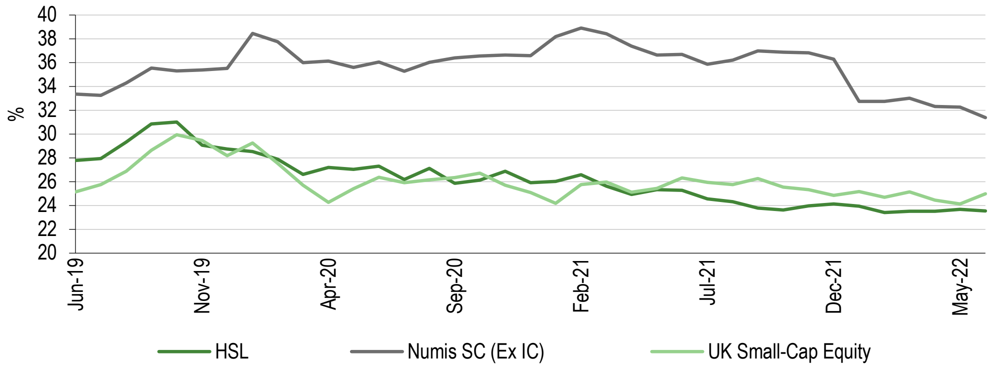
		Portfolio weight %				
Company	Sector	30 September 2022	30 September 2021	Change (pp)	Benchmark weight (%)	Active weight vs benchmark (pp)
Oxford Instruments	Technology	3.1	2.1	1.0	0.9	2.2
Balfour Beatty	Industrials	2.9	1.4	1.5	N/A	N/A
Impax Asset Management*	Financial services	2.7	3.1	(0.4)	N/A	N/A
OSB Group	Financial services	2.7	1.9	0.8	N/A	N/A
Future	Communication services	2.6	3.5	(0.9)	N/A	N/A
Serica Energy*	Consumer cyclical	2.5	0.9	1.6	N/A	N/A
Bellway	Consumer cyclical	2.5	2.4	0.1	N/A	N/A
Paragon Banking	Financial services	2.3	1.8	0.5	0.9	1.4
Watches of Switzerland	Consumer cyclical	2.2	2.1	0.1	N/A	N/A
Top 10 (% of holdings)		**23.5**	**15.0**			

Source: HSL. Note: The benchmark is Numis Smaller Companies (excluding investment companies), which does not include AIM-listed companies. *AIM listed. N/A indicates that the holding is not in the benchmark.

New holdings over nine months to end-September included brownfield land regeneration developer Harworth, security and defence contractor Qinetiq, private client investment manager Rathbones, digital rail and coach travel platform Trainline and flexible London and south-east office and meeting room supplier Workspace. Sales were made in Clinigen, Countryside Properties, Dechra, Frontier Developments, Gooch & Housego, James Fisher, Joules, Knights, Marshall Motors, Sherborne Investors and Ultra Electronics. The portfolio also benefited from the takeover of Brewin Dolphin, EMIS, Euromoney and RPS. It is clearly not possible to forecast bids, but in a portfolio with decent growth characteristics versus the broader UK small-cap market, Hermon is confident that there will be more M&A within the portfolio in 2023.

Each major small-cap downturn (2000, 2008 and now 2022) provides a lesson. While Hermon concedes that the valuation of the portfolio going into the slowdown was arguably a little high, an area that he has not compromised upon is leverage. 55% of the portfolio has net cash on the balance sheet, while only 5% has net debt above 2x EBITDA. The fund is managed via the '4Ms' process (see Investment process: Quality at the right price summary on page 9), which includes 'money' referring to the company's financial position, balance sheet, cash flows and debt profile. Red signals here are weakening fundamentals particularly cash outflows. Balance sheet strength very much remains a key metric that the team monitors (Exhibit 6).

Exhibit 6: Lower debt to capital than peers or the index

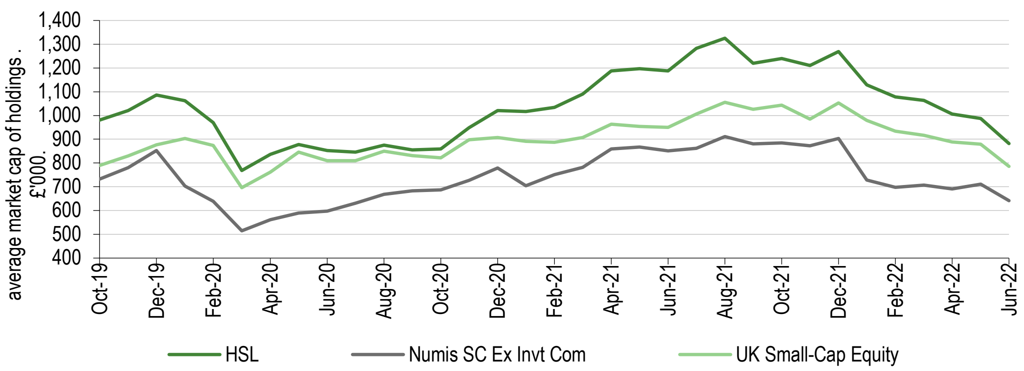


Source: Morningstar

Mid-cap bias and low turnover

The fund has a mid-cap bias, which provides liquidity and the ability for the fund manager to run his 'winners', which means that the fund is not forced to sell a strongly performing holding if it leaves the fund's benchmark (Exhibit 7). At 30 September the fund was 1.3% invested in the largest 100 UK companies, 63% in the next largest 250 companies, 16.9% in UK smaller companies and 32.2% in the alternative investment market (gearing 13.4%).

Exhibit 7: Mid-cap bias



Source: Morningstar. Note: All data in pounds sterling. At 30 June 2022.

The process focuses on the long-term fundamental attributes of the stock as identified via the 4Ms process. Should the investment thesis play out (where there are the inevitable errors in stock analysis, positions are cut quickly) then the manager ideally wants to capture the full potential of compounding growth by holding the stock as its price positively re-rates. This leads to a relatively low turnover portfolio, with an average holding period of over five years (Exhibit 8) and leads to a fund profile with a higher than average market cap (Exhibit 7) as the successful investment thesis plays out and the companies' market capitalisations increase over time.

Exhibit 8: Portfolio turnover versus peers (%)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2021	Average
HSL	19.4	13.5	21.8	24.8	28.2	28.5	25.2	27.4	19.0	17.6	20.1
UK Small-Cap Equity	36.0	69.1	59.4	38.3	48.6	90.3	81.9	9.3	70.2	47.5	33.6

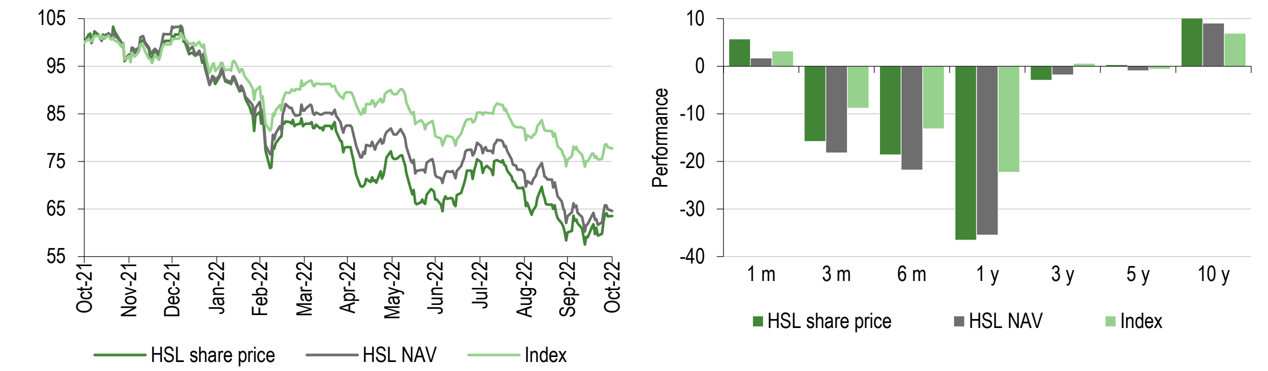
Source: Morningstar. Note: UK Small-Cap, Morningstar UK Small-Cap Equity peer group.

A challenging period for performance

The 12 months to the end of September have been a challenging environment for HSL's performance. The NAV return over this period has been -37.6%, versus the index return of -25.1% and the Morningstar UK small-cap peer group return of -30.8%.

Exhibit 9: Investment company performance to 30 October 2022

Price, NAV and index total return performance, one-year rebased | Price, NAV and index total return performance (%)

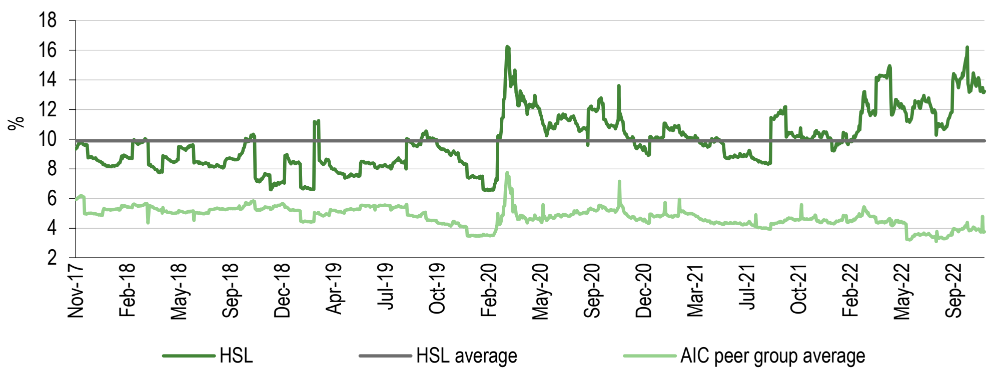


Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

In the 12 months to the end of September 2022, the top five contributors were Serica Energy, Clinigen Group, Balfour Beatty and Ultra Electronics. Not holding 888 Holdings was also a contributor, as it returned -88% over the period. In terms of detractors, the largest five stocks were Future, Synthomer, Impax Asset Management and Learning Technologies, while not owning Energean (it appreciated 53%) was also a detractor to relative performance.

While stock selection has been the main detractor to returns, gearing (in a falling market) and stylistic factors have also played a part. Although it has been a short-term detractor, gearing has been accretive to long-term returns for investors and is currently 12% and at the top end of the historical range. There are £50m of private placements and around £30m of the £85m available from a flexible revolving facility, so there is dry powder should it be required.

Exhibit 10: Active use of gearing



Source: Morningstar

Stylistically HSL is growth at the right price (GARP), but growth investing has been a difficult place to be invested in 2022 (Exhibits 11 and 12). The effect of rising interest rates and probable recession on long-duration growth assets has been a powerful force for P/E multiple compression, as discussed earlier in the report. In this regard HSL has been swimming against the tide in 2022, which has undoubtedly been a contributor to absolute and relative returns.

Exhibit 11: HSL is more exposed to growth as a style than the index and peers

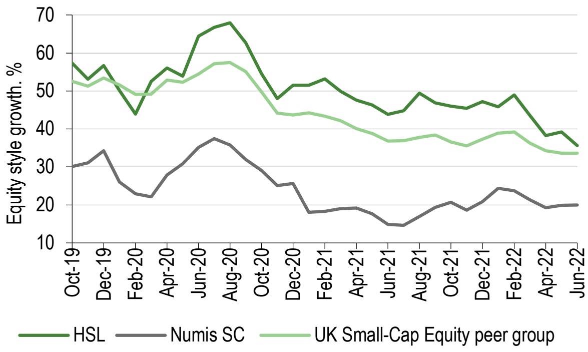
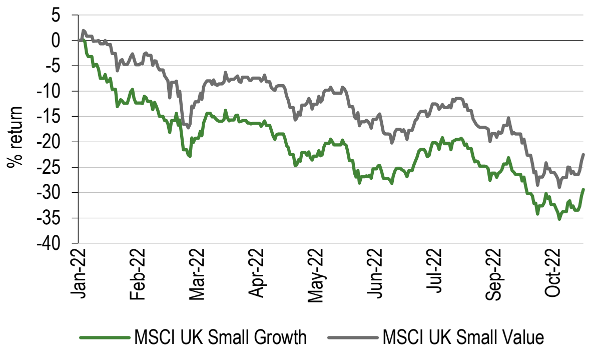


Exhibit 12: UK small cap growth underperforming value YTD



Source: Morningstar. Note: Numis SC = Numis Smaller Companies (ex-investment companies). UK Small-Cap Equity peer group = Morningstar UK Small-Cap category, which includes open- and closed-ended UK small-cap funds.

Exhibit 13: Five-year discrete performance data

12 months ending	Total share price return (%)	Total NAV return (%)	Numis Smaller Cos ex-ICs (%)	Numis Smaller Cos plus AIM ex-ICs (%)	CBOE UK All Companies (%)
31/10/18	0.3	(6.1)	(7.9)	(8.2)	(1.6)
31/10/19	10.7	7.4	3.4	1.7	6.9
31/10/20	(6.9)	(3.5)	(9.2)	(2.6)	(20.2)
31/10/21	54.8	51.9	44.5	43.5	36.0
31/10/22	(36.5)	(35.4)	(22.3)	(24.9)	(1.6)

Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

Long-term growth in capital and income

The AIC UK Smaller Companies peer group is a large and diverse group of companies spanning a range of investment styles, specialisms and approaches. Given the fixed pool of assets that the closed-ended structure provides, they are ideally suited to manage less liquid assets such as smaller companies, free from the constraints of providing liquidity to meet investor redemptions at short notice.

HSL has a number of notable features, which we highlighted in our initiation note (including fees and manager tenure). However, features that may be underappreciated (especially for a growth-orientated investment strategy) is HSL's current yield, its income record and, with a history of 19 years of consecutive dividend increases, it is a member of the AIC's 'next generation of dividend heroes'.

Exhibit 14: Selected constituents of the AIC UK Smaller Companies sector at 7 November 2022*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (cum-fair)	Net gearing	Dividend yield
Henderson Smaller Companies	592	(33.7)	(2.8)	(2.3)	145.1	0.42	Yes	-10.4	112	3.0
Aberforth Smaller Companies	1,036	(16.7)	5.2	1.8	123.1	0.75	No	-14.0	105	2.9
Aberforth Split Level Income	119	(19.2)	(3.7)	(11.6)	N/A	1.21	No	-15.0	142	6.9
abrdn UK Smaller Companies Growth	409	(7.2)	(5.3)	3.3	140.5	0.81	No	-10.7	103	1.8
BlackRock Smaller Companies	635	(29.4)	7.2	10.6	185.1	0.69	No	-15.1	98	2.7
BlackRock Throgmorton Trust	572	(39.3)	1.3	12.3	181.9	0.57	Yes	-3.9	105	1.9
Invesco Perpetual UK Smaller	142	(27.9)	(2.3)	5.1	149.3	0.92	No	-14.1	96	2.1
JPMorgan UK Smaller Companies	210	(29.4)	19.0	30.4	181.8	0.99	No	-14.3	107	2.6
Montanaro UK Smaller Companies	178	(33.2)	(6.5)	(9.1)	57.4	0.78	No	-5.1	104	6.0
Odyssean Investment Trust	168	(1.0)	45.2	N/A	N/A	1.45	Yes	2.3	94	0.0
Rights & Issues Investment Trust	118	(24.4)	9.4	1.0	211.9	0.35	No	-16.0	81	1.8
Strategic Equity Capital	137	(16.1)	8.0	6.9	164.1	1.08	Yes	-7.5	90	0.8
Average	359	(25.6)	6.2	4.4	154.0	0.84	N/A	-10.3	103	2.7
HSL rank in the selected peer group	3	10	9	9	7	2	N/A	5	2	3

Source: Morningstar, Edison Investment Research. Note: *Performance at 7 November 2022 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

Investment process: Quality at the right price

The investment universe is, at over a thousand companies, large and so to reduce this to more manageable levels the team uses broad-based screening on preferred metrics, including liquidity and market cap, and utilises its accrued knowledge over multiple cycles together with financial statement analysis. It will also draw upon its network of c 30 brokers with which it has built up long-term relationships to reduce the potential opportunity set to around 200 companies. The team can then carry out fundamental research on these companies, carrying out further in-depth due diligence including competitor analysis and meeting with company management (the team meets with over 300 a year). The investment process is based around the team's well-established '4Ms', which are used to assess a potential investment's merits. This incorporates focusing on the companies' models, management, money and momentum. It also serves as a process to review the ongoing merits of the investment thesis and deteriorating scores can result in a reappraisal of the buy case and can lead to an exit from the portfolio.

- **Model** refers to the company's competitive advantage, and any moats that might form barriers to entry, such as an enduring franchise. A company may not score strongly in this area but could still be included on the basis of its medium-term growth and valuation support. Sell signals could include undesirable changes in the company's strategy.
- **Management** addresses the quality of the leadership team, its past record, entrepreneurial and operational vision and skills, and whether it is aligned with shareholders and the governance is supportive of minority shareholders. Negative trends in management could include sudden/unflagged change in management and director selling.
- **Money** refers to the company's financial position, its balance sheet, cash flows and debt profile. Red signals here are weakening fundamentals particularly cash outflows.
- **Momentum** addresses near- and longer-term news flow that can drive the company's share price, and whether the company has the potential to post positive and persistent earnings surprises that should result in an ongoing share price re-rating, and how likely it is to continually beat market expectations. Areas of concern would be negative earnings surprises or earnings downgrades.

At this stage, the team also factors in valuation using measures such as P/E and EV/EBITDA multiples, free cash flow yield and dividend yield, depending on the most appropriate measure; ESG factors are also considered. With regard to valuation, the managers will reassess if they believe that the valuation has become too demanding, if there are violent unexplained movements in the price, if the price appreciation results in an outsized position, if there is a change in perceived risk or in the degree of upside potential. As already mentioned, any investee company that becomes one the largest 100 UK companies will be sold within six months.

The 4Ms process generates a portfolio of around 100 companies, constructed with position sizes dependent on conviction, risk considerations such as benchmark and liquidity measures (authorisation is required where JHI owns more than 10% of a stock or where 20% of a fund is made up of positions where JHI owns more than 5% of a company) and upside potential. The portfolio is primarily built from the bottom up, with sector weightings a resultant feature. However, occasionally top-down and more regularly risk considerations can have an impact upon sector weightings as per the sector and stock relative limits set out above. In addition, there is a weekly compliance sign-off process applied to the portfolio and pre-trade compliance monitoring via Charles River and a formal quarterly review meeting with the independent risk team. The tracking error is not targeted but has historically been in the 3–7% range.

The fund managers: Experienced and collegiate

Hermon began his career at Ernst & Young as a chartered accountant before joining General Accident and becoming head of UK smaller companies. He subsequently joined Henderson in 2002 as head of UK smaller companies, becoming director of UK equities in 2013. Hermon was appointed as manager of the Henderson Smaller Companies Trust in November 2002. Indriatti Van Hien began her career at PricewaterhouseCoopers, where she qualified as a chartered accountant. She joined Janus Henderson Investors as a UK equity analyst in 2011 before becoming a portfolio manager in 2016 and deputy fund manager on this fund in June 2016. The third member of the team is Shivam Sedani, who joined the team in 2017. All three are qualified accountants, which we feel is a particular strength in smaller companies investment, allowing a more in-depth and rigorous analysis of a company’s balance sheet and financial strength.

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