The little trust that could

A plucky performance saw this small cap trust end the year ahead of a strong pack in our annual top picks challenge...

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The Temple of Apollo at Delphi was not the only place in ancient Greece where it would've been possible find an oracle but the predictions of the Pythia, the high priestess of Apollo, were by far the most highly regarded and the steady stream of supplicants that the shrine attracted brought great riches to the temple complex wherein it sat.

Like the Pythia, the team at Kepler Trust Intelligence has a storied reputation (though great riches remain AWOL) and has been known to predict the future after descending into a trancelike state whilst seated on a three-legged stool, doing so habitually at about this time of year as the combination of eggnog, a persistent chesty cough and too many deadlines in too short a period of time begin to really make their mark.

Unlike your ancient forbears, however, you do not have to sacrifice a goat or purify your mortal flesh by bathing in a nearby sacred spring to benefit from their wisdom. Next week, the team's predictions for 2025 will be live on the site for you to interpret as you will[1].

In the meantime **you can tell us which trusts you think will perform best next year**, while we look back to our analysts forecasts from this time last year and discuss the slings and arrows of outrageous fortune that they have since faced, during another tumultuous twelve months for investors.

Last Year's Selections

Analyst/picker	Trust	NAV Total Return (Cumulative)	Share price Return (Cumulative)
Jo Groves	Rockwood Strategic	26.01	28.84
Ryan Lightfoot Aminoff	Shires Income	10.43	12.53
Thomas McMahon	Brown Advisory US Smaller Companies	4.61	10.25
Josef Licsauer	CC Japan Income & Growth	12.35	9.32
Alan Ray	The European Smaller Companies Trust	-1.02	4.84
William Heathcoat Amory	NB Private Equity Partners	1.36	-0.29

Source: Morningstar, as at 19th December 2024
Past performance is not a guide to future returns

Jo Groves | Rockwood Strategic (RKW)

My 2024 pick, which romped home to victory in case that wasn't clear, was **Rockwood Strategic (RKW)**, was based on two main factors: attractive UK small-cap valuations and the proven track record of manager Richard Staveley. When I wrote my spiel a year ago, the MSCI UK Index was trading on a trailing price-earnings ratio of 11x, less than half the 24x ratio of its US counterpart. We've had a couple of early dawns, but the valuation gap has since widened, with the MSCI UK nudging up to 13x versus 29x for the US (as 29/11/2024).

Valuations aside, my other motivation lay in the trust's focus on 'self-help' strategies rather than being hostage to the fortunes of the broader economy. This approach has helped Rockwood outperform the FTSE Small Cap and AIM indices by an impressive margin over the last three years.

My hope for a "long-awaited re-rating of UK equities coming to fruition" may have been overly optimistic, but Rockwood had nevertheless fired me to glory. Or so I thought, until my colleague Ryan crunched the numbers and Nick Todd's pick of Brunner nudged Rockwood into second place by the narrowest of margins (though it would have been a different story on NAV returns, with Rockwood achieving a total return of 25% compared to 13% for Brunner).

Without wishing to harness my inner Trump in facing defeat with an utter lack of graciousness, I may or may not have asked for a stewards' inquiry as to whether Nick's pick still counts as he has since moved onto pastures new. Alas my appeal fell on deaf ears so I'm toying with bribing Ryan into re-running the numbers daily for the next fortnight until victory is in my grasp.

Turning to the success factors, RKW's concentrated portfolio has been a tailwind for returns, allowing the manager to take an active, private-equity-style approach to instigating operational and strategic changes where needed. One standout example is the sale of business loan provider Funding Circle's loss-making US operations which helped to drive a year-to-date share price increase of around 230% (as at 10/12/2024). Similarly, communications specialist Filtronic's share price has soared by a similar amount on the back of a partnership agreement with SpaceX.

Considering that stock market darling NVIDIA has 'only' risen by around 190%, that's none too shabby and showcases a few of the hidden gems in the UK small-cap universe.

Ryan Lightfoot Aminoff | Shires Income (SHRS)

After a solid mid-table finish in my debut year, my 2024 pick, **Shires Income**, has seen me move up the table and into a respectable second place with a share price total return of 12.53%. Not only is this a pleasing result in absolute terms, but SHRS' performance was also ahead of its benchmark, the FTSE All Share Index.

My reasoning for selecting SHRS was the number of idiosyncratic factors that could drive performance. This includes a decent weight in smaller companies, which could benefit from a long overdue UK recovery, and also an allocation to preference shares, which offer defensiveness should the economic malaise fail to lift, but could also benefit from interest rate cuts which may result in capital uplifts as a result of yield compression. These factors have likely helped drive performance, although I believe SHRS and the UK more widely remain attractively valued. Despite positive absolute returns, the UK market has underperformed global indices and many companies are at lower valuations versus their international peers.

Furthermore, the discount on SHRS has widened out in the year, continuing to offer an attractive entry point in my opinion.

Overall, I am pleased with the result of my SHRS pick. The trust has outperformed its benchmark, offered resilience in a potentially challenging year and, most importantly, put me ahead of the majority of my colleagues.

Thomas McMahon | Brown Advisory US Smaller Companies (BASC)

Brown Advisory US Smaller Companies (BASC) has had a decent rally since the US election, and the share price discount has slightly narrowed too. However, it has had profoundly average results in the context of our competition, and sadly hasn't kept pace with its benchmark. The US small cap market has outperformed BASC by around 900bps. What I envisaged happening was a gradual US rate cutting cycle which would have a positive impact on US stock market valuations. With the large caps having run away in 2023, I thought this would lead to a slow re-rating of the small cap space. What we really had was more of the same until the election, with large caps outperforming, and then and then a broad-based dash for US equities which saw the poorest quality stocks bid for more aggressively. BASC's quality growth approach has therefore lagged the market. It may be a lesson that you shouldn't build a 12-month investment strategy on expectations for interest rates, but also that events can lead markets in unexpected directions – one of the key reasons nobody should be investing in just one fund!

Josef Licsauer | CC Japan Income & Growth

Having been at Kepler for just over a year, this has been my first full year trust pick. And, for my legion of fans out there, you'll be happy to know that my pick – **CC Japan Income & Growth (CCJI)** – was solid. Whilst it didn't top the table for share price returns, preventing me from earning a year's worth of bragging rights, it performed strongly against its own benchmark. Whilst an encouraging performance given the volatility we've seen this year, it hasn't been a completely smooth ride.

Japan's history is chequered and has scarred those long-standing investors who remember the fall out following the bursting of the country's economic bubble in the late 1980s. The result of this seismic shock has led to investors being quick to react to market wobbles, volatility, or the potential impact of wider events over the years, in the scenario that history could be repeating. We saw this in August 2024, where Japan's Nikkei 225 index closed more than 12% down – its largest fall since Black Monday in 1987.

This stemmed largely from Japan's rate hike, which caused the yen to surge against the US dollar, and made Japanese exports less competitive, prompting investors to unwind carry trades, where they had borrowed in Japan's low-interest environment to invest in higher-yielding US assets. However, this is a fantastic opportunity to bring in the old adage – it's all about time in the market, not timing the market. For those investors who resisted the initial knee jerk reaction of selling out of their Japanese investments, out of principle or simply because they forgot to look at the market or check their investment accounts for 24 hours, the movement in the market would have gone largely unnoticed. Whilst CCJI took an initial hit, erasing much of its strong first-half-year performance, it, much like Japan's stock market, rebounded after 24 hours by around 10%.

Market hiccups aside, I continue to think that the structural long-term drivers in Japan will be more significant for investors than things like short-term currency gyrations. Japan remains an under-researched market, supported by several underlying factors, from transformational changes spearheaded by corporate governance reforms and its welcome of positive inflation, to being seen as an alternative destination given investor antipathy towards China.

Overall, I am pleased with the result of my pick. CCJI, backed by the experienced Richard Aston, has proven the ability to deliver strong total returns since it launched in 2015, making the trust a compelling choice for investors looking to gain access Japan. The portfolio is a well-constructed, diversified list of companies, which will add differentiated sources of alpha to western-heavy portfolios, as well as providing exposure to the country's exciting developments and arising opportunities from its improving dividend culture.

Alan Ray | European Smaller Companies Trust (ESCT)

Last year's pick was the **European Smaller Companies Trust (ESCT)** and although this has finished in positive territory, it's probably not the share price return that an investor is looking for from a smaller companies trust. Essentially, the trust and its benchmark suffered from a reversal of the tentative recovery in sentiment in the first half of the year, when the trust's price was up over 15%, First, because the interest rate cutting cycle stalled and second because the US election has changed a lot of things for a lot of investors. For many investors, Europe doesn't seem to be an obvious beneficiary of the new US administration and markets have responded negatively. I think though, that the main thesis for ESCT remains in place:

- Smaller companies in Europe are, on average, undervalued. Over the last 20 years, European small caps have traded at a c. 20% premium to European large caps on a PE ratio basis, and roughly in line with US large caps. Today European small caps trade at a c. 7% discount to European large caps and almost a 40% discount to US large caps.
- Many of them can and do grow despite dispiriting macroeconomic figures for Europe as a whole, and this year there have been more upgrades than downgrades to consensus earnings forecasts, indicating that professional investors have underestimated growth.
- Europe isn't a single economic entity and there are several countries with notably more dynamic economies and stock markets than the weighted average.

For those reasons I'm going to say that ESCT's performance has been postponed rather than cancelled, so perhaps I'll stick with it for 2025!

William Heathcoat Amory | NB Private Equity Partners (NBPE)

2024 has been a frustrating year for NAV returns, compounded by the discount finishing 2024 around the same level as it started. Once again, lightening has struck the same place in equity markets, and US tech has been the only game in town. I had hoped that my pick for 2024, **NB Private Equity Partners (NBPE)**, would benefit from a broadening out of performance in the US market. However, the main reason for my choosing NBPE was that lower interest rates (which have not really come through yet) would re-enliven animal spirits in the private equity market, and that both deal activity would bounce back and valuations would also rise. Realisation proceeds would drive NAV growth in my thesis, but also enable the board to buy back shares if the discount remained wide. In the end, the macro scenario didn't play out, which in my view is why NBPE has not delivered a very exciting NAV performance for the second year in a row.

Whilst disappointing for NBPE shareholders, there have been encouraging signs and milestones hit during 2024. Firstly, whilst deal activity hasn't recovered to anticipated levels, there has been a reasonable level of realisations within NBPE's portfolio. Additionally, the underlying revenue and earnings performance of its portfolio companies have been decent, and overall the valuations of the portfolio's private investments have been positive.

Unfortunately, publicly owned investments (a result of previously private companies IPO'ing and continuing to be owned by NBPE) detracted over the year. Holdings of public companies within the portfolio have been reduced progressively over the year, and NBPE has successfully repaid its zero dividend preference shares, both representing progress towards a simpler and easier to understand proposition. The recent capital markets event (which we wrote up **here**), highlighted that NBPE's co-investment model gives it plenty of options, and is arguably well positioned in the current market. Unfortunately for the limited window of this competition, I have to accept that I've been timed-out!

In my view, the potential for NBPE to deliver strong returns in both NAV and share price terms remains strong. Private equity managers create value in a repeatable process over cycles, and NBPE is a great way to access this talent. NBPE's balance sheet and investment model allow it to hunker down if private equity markets continue to 'go slow'. However, in a bullish scenario, realisation activity will start to build up, driving valuation uplifts, and NBPE will see cash coming back onto the balance sheet. The managers and board then have a number of options, including new investments or pursuing buy-backs.

Footnote 1 - Like the Greeks, we are not to be trusted bearing gifts. We make no promise that our prophecies are appropriate for your circumstances, and they do not represent a personal recommendation.

Think you can beat our analysts?

Tell us which trust you think will deliver the best share price total returns in 2025 **by clicking here**.

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