Results analysis: Brown Advisory US Smaller Companies

BASC offers exposure to under-appreciated quality growth small caps.

Update
03 October 2025

- **Brown Advisory US Smaller Companies' (BASC) results for the financial year ending 30/06/2025 show an NAV and share price total return of -3.7% and -1.0% respectively, compared to a total return of -0.7% for the benchmark Russell 2000. Sterling investors suffered from a weak dollar, and in USD terms the Russell 2000 returned 7.7% compared to the sterling return noted above.**

- **BASC's underperformance mainly occurred in the first half of the year, with speculative and non-profitable stocks not held in the portfolio driving the benchmark's return. Over the long-term BASC's manager tends to be underweight in financials, preferring companies with less volatile and more sustainable earnings. This underweight cost some relative performance during the year as financials performed relatively well. BASC's overweight positions in industrials and information technology, and underweight in energy, all made positive contributions to performance, as did positive stock selection in the more out of favour healthcare sector.**

- **BASC's discount at the year end was 10.4% (9.8% at 29/09/2025) and averaged 10.0% over the financial year, narrower than the 11.4% average over five years. The board's buyback policy, established in 2023, is to use share buybacks with the aim of reducing discount volatility and working to reduce any discount to the extent that it is significantly wider than those of similar investment trusts. During the year c. £4.3m shares were repurchased at an average discount of 11.3%. For context BASC's market cap is c. £150m.**

- **Gearing was not deployed during the year. The board and manager took the view that, with rates holding firm, an unsettled political backdrop and limited investor appetite for US small caps, it would be better to hold a small net cash position. The board notes that if prospects for the smaller company sector and investor interest improves, it will review its gearing policy which it believes is one of the key benefits of a closed-ended structure.**

- **A new management fee was introduced from 01/01/2025. Fees are calculated on the lower end of net asset value and market cap (previously: net asset value). The first tier, up to £200m, saw a reduction in the fee from 0.70% to 0.65%. The remaining tiers are 0.60% on the next £300m and then 0.50%. BASC's market cap, £150m, currently puts the fee within the first tier.**

- **The board has also introduced a conditional tender offer. Should BASC underperform its benchmark for the five year period ending 30/06/2028, shareholders will be given the opportunity to realise up to 100% of their holding via a tender offer. This is in addition to the existing continuation vote, held every three years and next due in November 2026. At the last vote in 2023, 90.5% of vote cast were in favour of continuation.**

- **Chair Stephen White said "We believe US equity markets should continue to draw support from the economy staying in reasonable shape and from expectations of a steady cutting in interest rates. Smaller companies should also benefit from a return of investor interest given their relative underperformance of late versus the large caps and their attractive valuations. The**

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weaker dollar is also less of a negative factor for the latter given their greater domestic exposure. That said, markets are likely to remain volatile as they have been these past months as they are shaken from time to time by unpredictable geopolitical squalls, from both home and abroad."

Kepler View

During **Brown Advisory US Smaller Companies' (BASC)** financial year the narrow market leadership that has characterised the last few years continued, with the S&P 500 up c. 6% in GBP terms compared to the Russell 2000's small decline. Currency proved to be a significant factor over the same period, knocking about nine percentage points off BASC and its benchmark's performance when converted to sterling. Since the financial year end, market leadership has continued to rest with the same mega-cap US stocks, and the S&P 500's 12-month return to (29/09/2025) of c. 17% is comfortably ahead of BASC's benchmark, at c.10%, and BASC itself, about level in NAV terms (all figures in GBP).

BASC's investment strategy doesn't lend itself to momentum driven markets and manager Chris Berrier notes that on top of the narrow group of US large caps driving the index's performance, a similar thing is occurring in the Russell 2000 universe, with lower quality, often pre-profitable companies showing the greatest momentum. Further, financials, in particular banks, rarely meet the quality growth factors that the team focus on, and this sector has performed well in share price terms over the last year.

The manager assesses that many of the larger, long-term holdings in the portfolio have performed well at an operational level and recent market volatility has allowed positions in many of these to be increased at an attractive share price. In addition, the core of the portfolio built around c. 40 stocks has been augmented by a number of newer ideas and earlier stage businesses where valuations also appear attractive. There has been no change in BASC's investment proposition over the period, but Brown Advisory has taken on some extra resource in its investment team, including an additional research analyst covering the technology sector. `

Clearly recent performance has been disappointing but it's important to note that the main reason for this is that the stock market has chosen not to reward compounding growth quality companies, and instead favour high growth and more speculative businesses, rather than underperformance being explained by a series of companies with disappointing operational results. The BASC board has introduced a performance-related tender offer, which will give all investors the chance to realise their entire holding should performance lag the benchmark in the five years to the end of June 2028, and this, in our view, is a more measured way to address underperformance than to force change on an investment process that, over time, has delivered good performance.

In the meantime, BASC's manager does have a robust investment process that has performed well over the long-term, and we think that while the last phase of the US equity market has rewarded investors prepared to ignore diversification, that's not a situation we think likely to carry on forever. A few cents allocated to small caps for every dollar allocated to large caps could be all it takes to change the momentum in BASC's favour.

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