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# Investing in UK micro-caps with investment trusts

Why investment trusts are uniquely positioned to unlock  
the long-term growth potential of UK micro-caps.

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For the best part of a decade, one trade has dominated. Buy America, buy the S&P 500, buy the Magnificent Seven, the financial death star sucking the world's money into a mere handful of stocks. That trade may have delivered spectacular returns, but whether priced-for-perfection valuations leave sufficient upside is more debatable.

Even UK investors eschewing the US for their home market have stayed firmly in large-cap territory. On the face of it, this proved a sound decision, with the FTSE 100 notching up a 26% return in 2025, almost three times the S&P 500. Indeed, Rolls-Royce eclipsed six of the Magnificent Seven with a five-year return of almost 1,000%, though even that fell short of NVIDIA's eye-catching 1,600%.

Both, though, were laggards against the real star of the period. You probably haven't heard of Filtronic, a Durham-based manufacturer of high-frequency amplifier modules for Starlink satellites, but partner SpaceX certainly has. And Filtronic has delivered a stellar five-year return of 4,400% for investors in return.

But Filtronic isn't a one-off. Since 1955, £1,000 invested in US equities would have grown to £107,000 in real terms. The same amount in the bottom 2% of the UK equity market, the DNSC 1000 XIC Index, would have soared to £1.1 million.

This performance gap stems from a sector that remains stubbornly under-researched, under-owned and under-appreciated. However, for investors willing to venture into the smallest end of the market, rich pickings can still await.

### What's a micro cap?

The difference between small and micro-caps is wider than the label suggests. The MSCI UK Small Cap Index covers just under 200 companies with an average market cap of £1.7 billion, and the largest constituent sits at over

£9 billion. By contrast, the MSCI UK Micro Cap Index spans over 350 companies with an average market cap of £125 million.

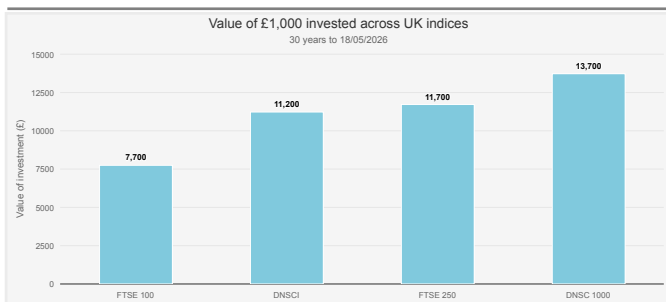
Most dedicated strategies focus on the £20 million to £250 million range, though successful holdings can grow well beyond this. However, many small-cap trusts have quietly drifted up the market-cap scale in recent years, making dedicated micro-cap trusts an increasingly differentiated proposition.

### Why invest in UK micro-caps?

#### A long-term record of outperformance

Not only have UK micro-caps consistently outperformed their larger-cap peers over the longer term, but they've done so by a significant margin.

#### Micro-Caps Have Outperformed Their Larger-Cap Peers



Source: FE Analytics, based on total returns, rounded to nearest hundred  
Past performance is not a reliable indicator of future results

As shown in the chart below, £1,000 invested 30 years ago in the FTSE 100 would be worth £7,700 today. Not a bad return, but you'd be sitting on a pot of £13,700, almost double the large-cap return, if you'd put the same money into the bottom 2% of the UK market.

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And this outperformance came during a period when markets were buffeted by the dot-com crash, the global financial crisis and the pandemic. While individual smaller-cap stocks are more volatile than larger-cap peers, a diversified portfolio and a long-term investment horizon help to mitigate this risk.

As legendary investor Jim Slater put it: “Elephants don’t gallop. To double the earnings of a £10 billion company takes years of hard work. To double a very small company is a much easier task.” Beyond the arithmetic advantage, smaller companies tend to be nimbler, with flatter management structures to capitalise more quickly on new opportunities.

### **Attractive valuations**

UK smaller caps continue to trade at a significant discount to both long-term averages and international peers. On a forward price-to-earnings basis, the MSCI UK Small Cap Index is trading at a 35% discount to the equivalent US index and 11% below Europe (as at 30/04/2026).

The discount to large-cap UK equities has also widened sharply. Two years ago, the Deutsche Numis Smaller Companies Index (DNSCI) traded at a 24% premium to the FTSE All-Share on a price-earnings basis. This has since reversed to a 22% discount, with the rerating in large-caps yet to meaningfully broaden out to the lower end of the market.

M&A activity tells a similar story, with overseas and financial buyers paying significant premiums to snap up almost £90 billion of public companies in 2024 and 2025, including 49 companies from the DNSCI and AIM last year alone. Added to this, UK-listed companies have been buying back their own shares in the belief that the market is not fully recognising the intrinsic value of their businesses.

Structural tailwinds are also gathering on both the retail and institutional fronts. The Financial Conduct Authority’s overhaul of the listing rules - the most significant reform in three decades - should make London a more competitive home for growing companies. The Mansion House Accord is expected to unlock £25 billion of additional investment into UK assets by 2030, while proposed cuts to the cash ISA allowance could nudge retail capital towards UK equities.

As a result, even a modest improvement in investor appetite could prompt a meaningful rerating in UK small-caps.

### **Hiding in plain sight**

The micro-cap universe is the broadest across the UK equity sector, with around 600 companies below £150 million listed across the main market and AIM. It’s also far less concentrated than its large-cap peers, with the top-ten stocks accounting for 60% of the MSCI UK Large Cap Index, but just 14% for its micro cap equivalent.

Yet this universe receives remarkably little coverage. The FTSE 100’s largest companies are covered by an average of 24 analysts each, falling to nine for the FTSE 250. The same figure is five for the FTSE Small Cap Index, and some micro-caps have no analyst coverage at all.

In addition, the liquidity constraints and wide bid-offer spreads of micro-caps are poorly-suited to index-tracking funds, leaving the field largely to active stock-pickers. This can create genuine pricing anomalies for active managers to exploit through in-depth, private equity-style due diligence.



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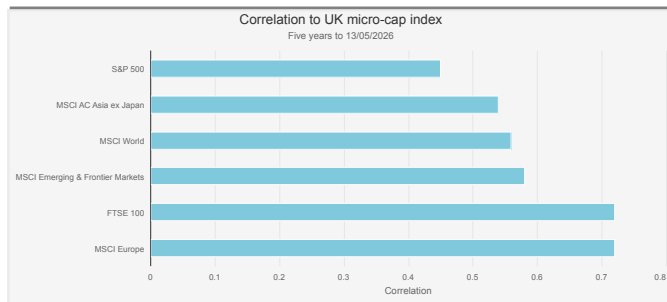
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## Portfolio diversification

The UK micro-cap sector offers diversification beyond market cap alone. UK micro-caps have a correlation of below 0.5 with the S&P 500, providing differentiated exposure for

### Micro-Caps Have A Lower Correlation To Us And Global Indices



Source: FE Analytics, based on DNSC 1000 XIC in GBP

investors with a high weighting to US mega-caps. Nor is it purely a domestic story, with many micro-caps generating a significant proportion of revenues overseas.

From a sector perspective, the FTSE 100 is heavily weighted towards financials, energy and healthcare,

which are sensitive to interest rates, currency swings and commodity prices. Micro-caps, by contrast, are tilted towards technology, industrials and consumer discretionary, and company-specific factors tend to play a larger role in driving returns than the macro backdrop.

## *How difficult is it to invest in UK micro-caps?*

Investing directly in individual micro-cap companies can be challenging, as the universe spans everything from early-stage, more speculative companies to established businesses operating in high-growth niches. Assessing a broad range of factors from financial resilience and management quality to competitive positioning can therefore be difficult without direct access to the companies.

Shares can also be illiquid, with wider bid-offer spreads than the larger end of the market and, at times, limited availability on mainstream retail platforms. Volatility tends to be higher too, reflecting lower trading volumes and greater sensitivity to sentiment.

As a result, micro-caps are best suited to investors with a longer time horizon. As successful companies are promoted into larger-cap indices, liquidity improves, the investor base broadens and the micro-cap discount often unwinds.

## *Why invest in UK micro-caps with investment trusts?*

By investing through a trust, investors gain exposure to a professionally managed, diversified portfolio rather than taking on the risks of individual stock selection.

There are around 20 trusts within the AIC UK Smaller Companies sector, although only a handful have a genuine micro-cap focus. Mandates vary significantly, with some managers running a highly concentrated, high-conviction portfolio, while others adopt a broader approach.

The closed-ended structure of investment trusts is particularly well-suited to the micro-cap sector. Unlike open-ended funds, trusts are not forced sellers in periods of outflows, allowing managers to take a genuinely long-term view and hold more illiquid positions without the pressure of redemptions. They can also use gearing to

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enhance returns and retain revenue reserves to smooth dividend payments, which aren't available to open-ended funds.

The most successful managers combine in-depth expertise and resources with an active approach to value creation. **Rockwood Strategic (RKW)** is one such example, with portfolio company Filtronic illustrating the rewards of skilled stock-picking at the micro-cap end of the market.



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# Case Study

## Rockwood Strategic (RKW)

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**Launched:** 2015

**Manager:** Harwood Capital

**Ongoing charges:** 1.83%

**Investment policy:** The trust aims to invest in securities under £250 million that the manager believes can generate a 15% IRR (internal rate of return) over a three-to-five-year time period.

**Comparative Index:** FTSE Small Cap (ex-Investment Trusts) Index, FTSE AIM All-Share Index

**Rockwood Strategic (RKW)** aims to deliver long-term growth for shareholders by investing in a concentrated portfolio of UK smaller companies.

In the five-year period to 15/05/2026, RKW has delivered a share price total return of more than 130%, the highest in the AIC UK Smaller Companies sector and well ahead of its AIC peer group average.

### 1) What kind of stocks does the manager like?

Manager Richard Staveley is a bottom-up stock picker, looking across a universe of over 500 companies across the FTSE Small Cap and AIM indices but excluding biotechnology, early-stage resources and unproven technology businesses.

Richard looks to capitalise on pricing inefficiencies from a lack of research, with a particular focus on companies under £250 million. He looks for companies with the potential to generate strong free cash flow, a proven business model and identifiable assets at attractive absolute valuations.

The trust can invest up to 15% in unlisted companies, although this is not an area of focus, and there are currently no private holdings.

### 2) Are investment decisions driven by a particular investment style?

Richard has a value-oriented investment style, which differentiates the trust from its quality growth-oriented peers.

Richard takes a private equity-style approach to managing portfolio companies, identifying the catalysts for an improvement in profitability and shareholder returns. He will also actively engage with management teams and stakeholders to execute the

necessary operational, strategic and management or board evolution to unlock, recover or create shareholder value.

Richard develops an exit thesis prior to investment, which seeks to mitigate the illiquidity risks of buying material stakes in smaller-cap companies. The trust will typically hold investments for three to five years to allow time for strategic or operational changes to be executed and a corresponding rerating in valuation.

Richard believes that the majority of the portfolio will ultimately be acquired by a trade or private equity buyer. Rockwood has received a number of offers for portfolio companies in recent years, and acquisition premiums have been a tailwind for returns due to the concentrated portfolio.

### 3) How many stocks does the investment trust typically hold?

The trust holds a concentrated portfolio of around 20-30 stocks, split between 'core' holdings (5-15% stake) and 'springboard' holdings (2-4%). It is expected that there will be up to ten core holdings and 10-20 springboard holdings.

### 4) What is the investment trust's dividend policy?

RKW pays out at least 85% of net income received after expenses, but dividends are not a significant feature of the trust.

### 5) What are the investment trust's ongoing charges?

The investment trust's ongoing charges are 1.83%.

### 6) Does the investment trust have performance fees?

The management fee is 1% of net asset value. There is also a performance fee of 10% based on net asset value returns over a 6% annual absolute hurdle rate, with a total (management and performance) fee cap of 3% of NAV.

### 7) How much attention does the manager pay to the index?

The manager takes a highly active, benchmark-agnostic approach.

## **8) Does the investment trust use gearing and, if so, is it structural or opportunity-led?**

The manager can use gearing up to 20% of net asset value, although there are currently no plans to utilise this in the foreseeable future.

All returns are based on total share price returns in GBP and data as at 18/05/2026, unless otherwise stated.

[View the latest research note here](#)

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