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The out of favour trusts beating the S&P 500

We highlight how well some UK small cap trusts have done despite all the negativity.

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One of the weirder moments in the B****t wars was when social media users fought over the use of Union Jack flags on vegetables in British supermarkets. A surprising number of people who were apparently capable of using full sentences and finding the internet viewed this as a retrograde, fascistic step and indicative of how nasty Little Britain was becoming in its new dark age. What their comments really showed is that they had never lived abroad, because, as anyone who has done so would know, every country's supermarkets stick flags and proud claims of national origin on their food and have always done so. The point is: if you only know your own country, what do you really know about it?

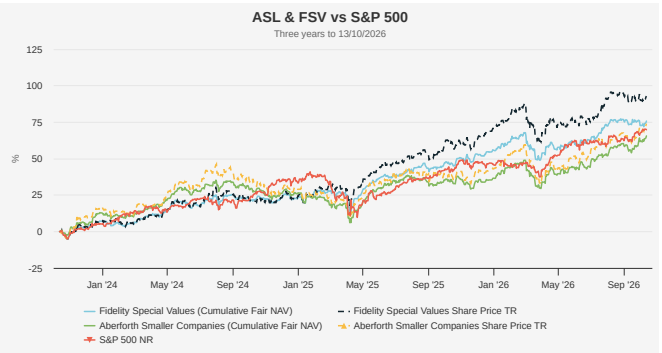
Britain is very focused on its own economic problems, but it doesn't shape up too badly by international standards. This was the message of the IMF's report last week, which was met with rather a lot of surprise and scepticism. But the numbers are clear. Rising gilt yields are a problem, but there are plenty of countries more likely to have a fiscal crisis before the UK. Britain's fiscal deficit is 3.8% and falling. This compares to 5.4% in France and 8.5% in the US. Gross government debt sits at 104% of GDP versus 119% for France and 127% for the US. UK economic growth of 1.3% is higher than all G7 countries except the US, and level with Germany's. For all the political mud-slinging, the general economic approach of the governments in the current parliament hasn't been drastically different from the last Conservative government, in the basic focus on fiscal discipline.

We could make a similar argument when it comes to the health of the stock market. While the UK frets about delistings and takeovers, this is a global phenomenon which has hit our European neighbours hard too. The number of listed companies on the Euronext Paris exchange has halved since 2006. In the US, there has been a 37% decline over the same period. There is a real issue about valuations in the UK, but a large part of the deequitisation going on is attributable to global factors.

The problem for investors is that poor sentiment is itself a driver of poor returns, and with sentiment towards the UK particularly dire, investors may quite reasonably be sceptical about the market's prospects. However, investment trusts focused on undervalued UK equities have actually outperformed the S&P 500 over the past three years, even though the mood music has been relentlessly negative on the UK and the US has benefitted from the impact of AI on the tech sector.

The chart below shows the returns of Aberforth Smaller Companies (ASL) and Fidelity Special Values (FSV), which sit in the AIC UK Smaller Companies and AIC UK All Companies sector respectively. In the three years ending 13/10/2026, FSV's NAV total return of 75.8% and its share price total return of 92.9% were well ahead of the 69.8% sterling return to the S&P 500. While ASL's NAV total return was slightly behind, at 65.6%, the share price total return was 74%. So, investors in both would have outperformed the famous low-cost tracker.

THREE-YEAR PERFORMANCE



Source: Morningstar

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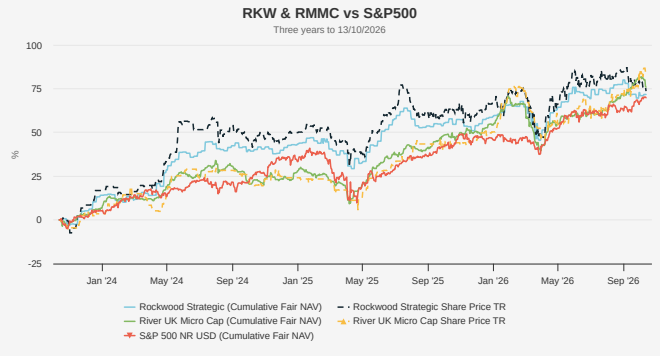
In the depths of the market, in the micro-cap segment, both trusts have also outperformed the all-conquering S&P. As the chart below shows, **Rockwood Strategic's (RKW)** NAV is up 71.7% and River UK Micro Cap (RMMC) 75.9% over the same period, and the share prices of both have done even better.

THREE-YEAR PERFORMANCE



Source: Morningstar

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These charts were pretty surprising to us, and we expect they are to many readers too. We think they just underline the point that waiting for sentiment to turn is a fool's errand. Sentiment will turn back towards UK equities when investors have made much more in their UK funds than their US or tech funds, but by then much of the outperformance will have been earned. While we don't think there is an AI bubble as such, we do think the market is becoming more discerning, and returns to tech-heavy indices will diminish. Anthropic's slowing revenue growth and China chip-maker CXMT's claims of a breakthrough in DRAM technology are two bits of news from last week which highlight the AI story is becoming more complicated, and investors should be looking elsewhere for growth. With UK valuations so low and higher rates likely for longer, we think the backdrop for value-focused strategies remains superior to that for growth strategies, although the time will eventually come for that even more out-of-favour strategy too.

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