Canaccord Genuity Wealth Management

Small-cap companies with **big prospects**

A guide to small-cap investing

Make the most of our **small business investment expertise**

Small companies can offer good investment opportunities. However, they are riskier and often ignored by investment and wealth management companies, who may lack the expertise and experience to evaluate small businesses, spot opportunities and invest on your behalf.

At Canaccord Genuity Wealth Management (CGWM), we do have that expertise. In fact, we are among the most experienced independent UK wealth managers in this area. And we believe smaller companies (or small-caps*) can be a very important part of a truly diversified and well balanced portfolio – whether you are investing directly in the shares of small-caps or via a specialist fund.

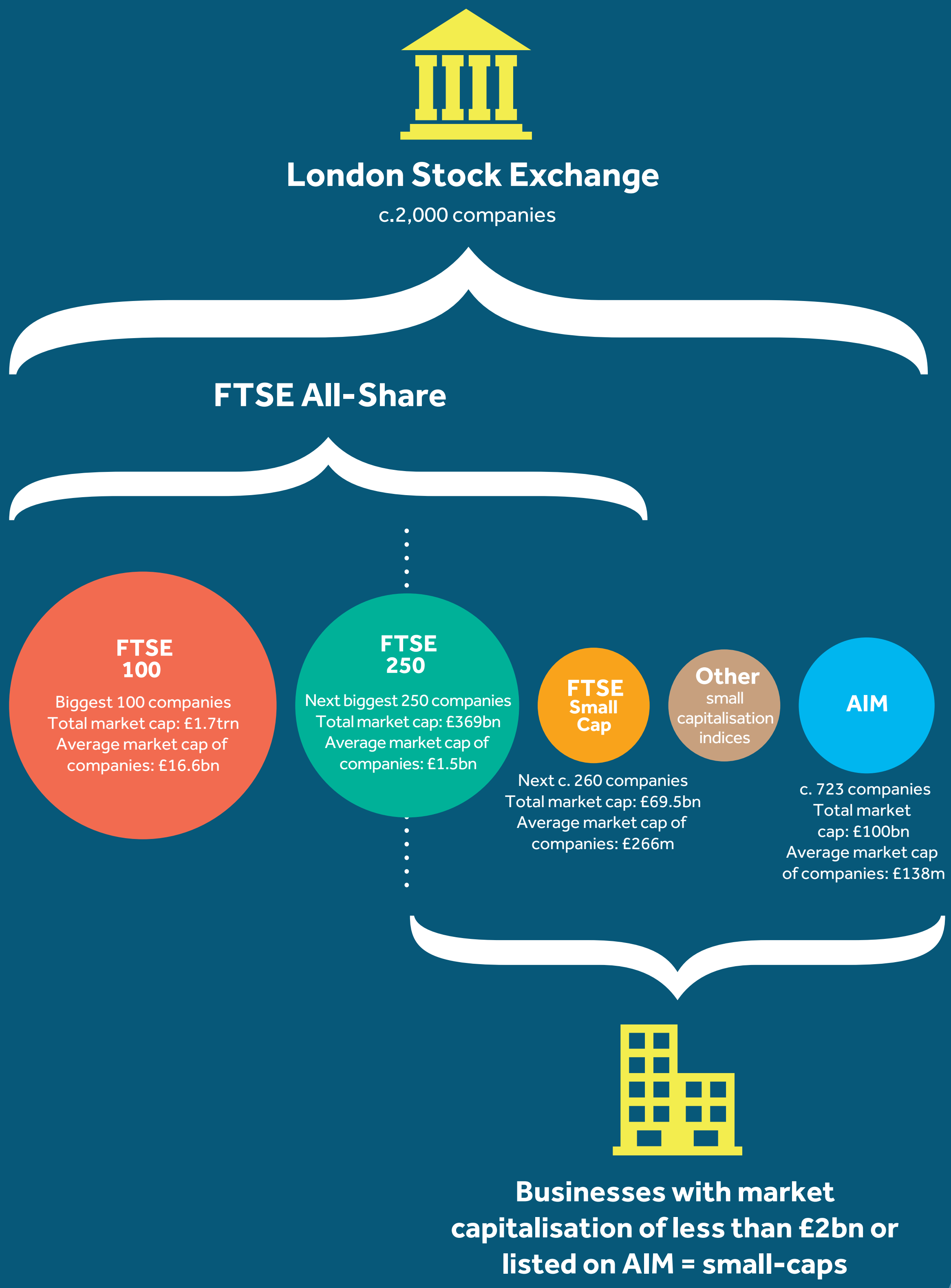
We will draw on this expertise to help you benefit from the attractive returns that can be available from small-caps, and include this niche area within your discretionary portfolio if we believe it's appropriate.

*Small companies are often referred to as 'small-caps', an abbreviation of 'small market capitalisation'.

Investments in small-caps, including AIM stocks, carry a higher degree of risk than investing in the more liquid shares of larger companies, so they may be difficult to sell at the time you choose. Investments in small-caps are more volatile and, while they can offer great potential, growth is not guaranteed. Please refer to page 9 for more information.

Investment involves risk. The value of investments and the income from them can go down as well as up and you may not get back the amount originally invested.

How we define **small-caps**



There are more than 2,000 companies listed on the London Stock Exchange, of which around 600 are in the FTSE All-Share Index.

The FTSE All-Share is made up of:

1. FTSE 350 – a combination of:
   a. FTSE 100 – the 100 biggest companies, such as AstraZeneca, Rio Tinto and Tesco
   b. FTSE 250 – the next 250 companies, including Wetherspoons and WHSmith

2. FTSE SmallCap – all the remaining FTSE All-Share companies, including Hilton Foods.

Beyond this is the AIM (Alternative Investment Market) where smaller companies, such as Fever-Tree, can float shares within a more flexible regulatory system designed to help smaller companies access capital from the public market.

When we talk about investing in small-caps, we mean companies that:

- Are listed on AIM
- Or have a market capitalisation of less than £2bn, but are not within the FTSE 100 – this includes companies within the FTSE 250, FTSE SmallCap and FTSE Fledgling indices.

The companies listed on AIM can have market capitalisations above £2bn.

Specialists in small-cap investing

Our specialist team has a wealth of experience and a strong track record. They continually research and analyse small-caps and equity fund managers, and their findings are backed by our rigorous, robust central investment office (CIO) team, which includes a dedicated small-cap investment committee.

We understand the risks involved in investing in small-caps, and will monitor and adjust your discretionary portfolio if necessary. Our Investment Managers won't rush to invest all your money at once; instead they will invest your money as and when they spot attractive opportunities.

Our Investment Managers regularly meet the management of small companies, equity fund managers and investment banks – and have done so for many years. Thanks to this personal contact, we have developed a breadth of relationships within the industry in an under-researched area; these can allow us to access opportunities that are not available to you as an individual.

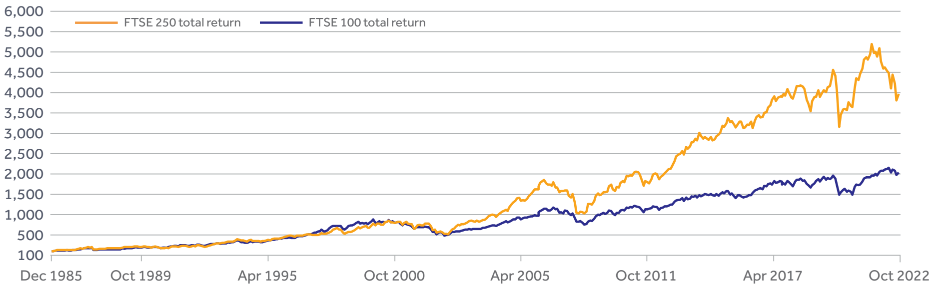
It also means we are often among the first to be offered shares in companies coming to the market and can react quickly on your behalf.

Please note this is not a recommendation to invest in any of the companies mentioned above. Names of companies are included for illustrative purposes only.

Why small-caps can make **attractive investments**

Small-caps can be attractive because they often generate better returns than companies in the FTSE 100.

Since the end of 1985, when comparative records began, the FTSE 250 Index has risen at an annualised rate of 10.7%, compared with 8.7% for the FTSE 100. This has generated a return of 4,168%, compared with 2,081% for the larger index. The effect is equally marked in other countries, including Germany, France and the USA.



Data as at end October 2022. Source: FTSE and Morningstar.

There are several reasons for this:

1. Firstly, small-caps benefit from the law of large numbers. It's easier to multiply the size of a £100m company by 10 than to grow a £100bn company to a £1trn company.

2. Smaller companies are more likely to be taken over, as their size makes them more digestible to the acquirer.

3. Sunset – or older, declining – industries are more likely to be represented in the big indices, while more innovative companies often form part of smaller indices.

4. Companies outside the FTSE 100 Index come from a wider range of sectors. Even though small-caps are seen as higher risk (and they do fail more frequently), the FTSE 100 companies tend to be concentrated within a limited range of sectors. This can lead to greater risk, as companies within the same sector tend to move together in the same direction.

5. Small-caps tend to be under-researched, and diligent experts and researchers (including those at CGWM) can often discover hidden gems.

How we invest your money

Because of the high-risk nature of most small company investments, we will usually invest your money in a diversified portfolio, which can include smaller company direct equities, or a specialist fund sourced by our fund research team.

If you choose our discretionary portfolio management service, your Investment Manager will build and run a personalised portfolio on your behalf – without the need to ask your permission each time they want to make an adjustment.

If you like to take an active interest in financial markets and want to buy and sell small-caps on your own behalf, our trading and dealing team can also offer you traditional stockbroking services. If you choose our advisory service, they will offer you quality smaller company investment ideas, based on recommendations from our in-house small-cap investment committee.

Some clients come to CGWM just for our small company investing expertise and may like to take advantage of our Small-Cap Portfolio Service. This is an equity-only and very high-risk portfolio only suited to certain types of investors who are willing and able to take higher risk and more volatility in exchange for potentially higher growth. Some clients use this service to carve out a small-cap investment portfolio as part of their overall wealth.

Choosing the best small-caps for investment

When we're selecting direct equities to invest in, our specialist small-cap investment committee carries out extensive research and analysis. They then create a shortlist of companies that meet our criteria. We look for businesses with high-quality management, a history of consistent earnings, dividend growth, balance sheet strength, proven cash generation, high barriers to entry, reasonable valuation, strong earnings growth, and owner managers.

Building on the criteria listed opposite, we look for opportunities in businesses within these categories:

- **Niche businesses:** companies that satisfy a specific market need, such as AB Dynamics, a supplier of integrated test systems for the global automotive industry; or Games Workshop, a manufacturer of miniature wargames
- **Roll-out stories:** companies that are expanding, either in phases or store-by store, e.g. Ten Entertainment, or Watches of Switzerland
- **Market leaders:** companies that enjoy the largest market share in their peer group, such as Domino's Pizza Group, or Marshalls, the leading supplier of building materials for garden design and construction
- **IPOs:** companies raising initial capital to help them transform from a private company to a public listed entity e.g. Auction Technology Group
- **Industry consolidators:** companies that are buying up their competitors and improving them, such as IT service management company Keywords Studios; Marlowe, a building services business, or Judges Scientific, a scientific instrument manufacturer
- **Special situations:** companies where our dynamic and nimble approach can exploit opening market opportunities such as forex service provider Alpha Group International, or identify early-stage management change and corporate turnaround, such as chemicals company Elementis, or PZ Cussons.

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Staying aware of the risks

Small-cap companies are high risk, so we will only suggest them as part of your portfolio if they are appropriate for your investment risk profile.

- There have been periods of as long as five years when they have underperformed their larger brethren
- They can be illiquid, which means they may be difficult to sell exactly when you want – or you may not be able to sell them at all
- They tend to fall further than the wider market when equities suffer from serious corrections
- They have a (possibly undeserved) reputation for being more financially fragile than large companies
- For income-seeking investors, larger companies are more likely to provide an income stream in the form of dividends, whereas smaller companies are more likely to reinvest profits back into the company
- They are more exposed to fluctuations in the domestic economy
- Their management team can often be opaque and hard to contact
- For the smallest companies, such as the AIM market in the UK, the performance track record has been much patchier.

Discover our **can-do** approach

Small-caps tend to be high-risk investments, but can also be profitable. If you're interested in including some in your portfolio, talk to your Canaccord Genuity Wealth Manager. They will listen to your request and carefully assess your needs and preferences.

We always tailor our service to suit individual needs, and your Wealth Manager will be happy to include small-cap investments if they are right for you.

If you would like to know more about how we go above and beyond to understand your investment needs and aspirations – and empower you to achieve them – get in touch. We will be delighted to answer your questions and provide details of our services.

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Telephone calls may be recorded.

Important information

Smaller company shares can be more volatile than those of larger companies because a small change in the financial performance can have a bigger impact on the company's value. These companies also tend to have less resources to overcome financial difficulties. Sometimes it can be difficult to buy and sell large volumes of these shares at the market price. Although smaller company shares can be traded on a regulated market, it is common for them to be traded on a less regulated market, or a 'multi-lateral trading facility', such as London's Alternative Investment Market (AIM). Companies whose shares trade on these markets are subject to less regulation than those on regulated markets.

Investment involves risk. The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. The investments described in this brochure may not be suitable for all investors. Investors should make their own investment decisions based upon their own financial objectives and financial resources and, if in any doubt, should seek advice from an investment adviser.

This document is for information only and is not to be construed as a solicitation or an offer to purchase or sell investments or related financial instruments. This has no regard for the specific investment objectives, financial situation or needs of any specific investor.

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