Marlborough International

UK smaller companies team COVID-19 update

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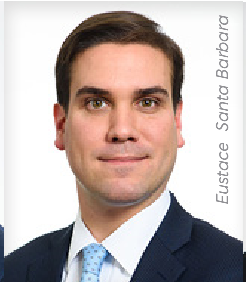

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Giles Hargreave, Eustace Santa Barbara & Guy Feld

What has been the impact of the COVID-19 outbreak on equity markets and why has it hit them so hard?

The COVID-19 outbreak has triggered sharp movements in global equity markets and the UK has been no exception, with the FTSE 100, FTSE 250 and AIM indices all falling dramatically and with unprecedented speed, then recovering some ground through several rapid one-day upward moves.

Initially, the economic shock was primarily supply-led, with global supply chains disrupted by factory closures and travel restrictions. Now though the principal issue has shifted to one of demand, with around 40% of the world's population in some form of lockdown, at the time of writing, according to global news agency AFP.

While there is still a lot of uncertainty about the short and medium-term effects on companies' earnings and cashflow, the picture will become clearer as we begin to understand the full impact of the virus and the economic measures launched in response by governments and central banks.

How have you responded to the outbreak and its impact on equity markets?

Where we felt the risk was not yet fully reflected in the share price, we have reduced our holdings in the companies in our portfolio that we believed were most vulnerable to the impact of the outbreak over the short and medium term.

Generally, these have been businesses that are cyclical in nature, which means those whose revenues are most sensitive to the wider economic environment, and those with higher operational gearing, which means they have significant levels of fixed costs that have to be paid regardless of what is happening to sales. Broadly speaking we tend to avoid these kinds of business and those with significant debt anyway, so our exposure was limited.

On the flipside, we have taken advantage of price weakness to add to our positions in companies that we expect to prove resilient during the crisis and beyond. For example, in Marlborough Special Situations and Marlborough UK Micro-Cap Growth, we have added to our holdings in Smart Metering Systems, which installs and operates smart meters on behalf of energy suppliers. In Marlborough UK Micro-Cap Growth we have also added to our position in Augean, which manages hazardous waste. In both cases we believe these are strong businesses, well-positioned to weather the storm.

Where are you now seeing opportunities?

The sharp moves in markets have created other opportunities. As rivals flounder, some companies could potentially emerge stronger from the crisis, where they have a strong competitive advantage, a robust balance sheet with little or no debt and revenues that are not heavily dependent on the economic cycle. Lower valuations are likely to offer attractive entry points for us to buy into these companies or add to existing holdings.

Our approach now is to look for companies where the share price has fallen further than is warranted. We believe a significant number of the UK's smaller companies have been unduly punished in this way.

What is your view on the investment outlook?

We are carefully considering the potential for lasting changes to the real economy and which existing trends may be accelerated. For example, the huge increase in the number of people working from home has increased demand for the hardware and software to do it. Another effect of social distancing has been to drastically escalate internet shopping. In both cases, what started as a short-term reaction could accelerate the longer-term trend, creating significant growth opportunities for companies serving these markets.

At a macro level, the stimulus measures by central banks are likely to result in interest rates remaining even lower for even longer. When we look ahead to a world recovering from the worst of the pandemic and one in which stock markets are less volatile, then, providing inflation remains under control, rates are likely to remain at historic lows. Such conditions should prove supportive for equities, as investors seek higher returns than those available from bonds and bank deposits.

In the meantime, while we do not know exactly where the bottom of the market will be, we believe that with share prices generally now significantly lower than they were in January, the risk/reward balance for investors is looking substantially more attractive. Against that backdrop, we are looking forward to identifying opportunities for our investors.

31st March 2020

Giles Hargreave and Eustace Santa Barbara are the Co-Managers of the **Marlborough Special Situations Fund**.

Giles Hargreave and Guy Feld are the Co-Managers of the Marlborough UK Micro-Cap Growth and **Marlborough Nano-Cap Growth funds**.

Risk Warnings

Capital is at risk. The following is a summary only of some key items in the Prospectus and more details can be found in the Prospectuses. Investors in Protected Cell Company (PCC) must have the financial expertise and willingness to accept the risks inherent in this investment.

Past performance is not a reliable indicator of current or future performance; it may not be repeated and should not be the sole factor considered when selecting funds.

It should be appreciated that the value of Shares is not guaranteed and may go down as well as up and that investors may not receive, on redemption of their Shares, the amount that they originally invested.

Investment in the Company should only be undertaken as part of a diversified investment portfolio.

Investment in the Shares should be viewed as a medium to long term investment.

Shares may not be redeemed other than on any Dealing Day.

There will not be any secondary market in the shares of the Company.

The individual cells of the fund act as feeder funds to various UK-authorised collective investment schemes, which may invest in smaller companies, and those listed on the alternative investment market (AIM), which carry a higher degree of risk than larger companies.

The shares of smaller companies may be less liquid and their performance more volatile over shorter time periods.

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Marlborough International Management Limited is incorporated in Guernsey.

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