MONTANARO

ASSET MANAGEMENT

Montanaro European Income Fund

Quarterly Commentary – Q1 2020

Before turning to investment matters, it is important to update you on how we are faring amid the Covid-19 pandemic. The team are working remotely and are thankfully all well. To a large extent, it is business as usual: our Analysts are speaking to the companies in which we invest; liquidity has not been a problem; and our operations are running smoothly. We have also just added to the team with the hire of a specialist Healthcare Analyst. We are fortunate that during the quarter we experienced net inflows and all Montanaro Funds outperformed their respective benchmarks. Our Quality investment style has again served us well in turbulent markets.

The first quarter of 2020 will enter the history books: the Bull Market came to a shocking end close to its 11th anniversary, as the S&P 500 recorded its second fastest 10% drop from peak since the Great Depression; the FTSE-100 suffered its worst one-day crash since Black Monday in 1987; the FTSE-250 fell for ten consecutive days, its worst run since 1998; UK SmallCap posted its second largest quarterly decline (-26%) since 1955; the European STOXX 600 Index experienced its worst ever one day fall (-11%); the oil price fell to levels not seen since 2002; and weekly jobless claims in the US exceeded 6.6 million (the highest weekly figure reached during the Great Financial Crisis of 2008 was less than 700,000). As financial markets saw large movements, the rest of the world halted: planes were grounded; shops, schools and factories closed; and by the end of March some 4 billion people had been instructed to stay at home. This was a true “Black Swan” event and one without precedent.

During the quarter, the NAV of the share class declined by 15% (in GBP).

The strongest contribution during the quarter came from **Galenica**, the Swiss pharmacy chain, which continued to trade given it is deemed an essential business. **Viscofan**, the leading supplier of artificial sausage casings, rose after reporting results towards the upper end of guidance. **Recordati**, the pharmaceutical company, outperformed the market as it secured new marketing approvals and benefited from the defensive nature of its business model.

The weakest contribution came from **Loomis**, the provider of cash management services, which declined amid concerns that the coronavirus would accelerate the transition away from cash payments. **Merlin Properties**, the Spanish REIT, weakened as shopping centres were forced to close across Spain. **MTU Aero Engines**, the aircraft engine manufacturer, suffered due to the grounding of many passenger flights.

The financial conditions stemming from the coronavirus most threaten businesses with structural weaknesses. Despite our Quality approach to investing – we invest in businesses with strong balance sheets who have a greater chance of weathering economic storms – we are taking nothing for granted.

We are speaking to our companies to understand how the crisis is changing their operating conditions and how it has impacted staff. We are also checking balance sheet stability, dividend payments, the availability of credit facilities and the potential for future funding requirements. Finally, we are trying to assess what opportunities may emerge from the darkness of the pandemic.

It is almost certain that the dividend income received from our companies will be lower this year than it was last year. We have seen a number of companies cancel, reduce or postpone their dividends already and expect more to follow suit. This is not necessarily out of financial necessity: many are doing so because they see paying dividends in the current environment as the wrong message to give to both staff and the wider world – particularly if they are making use of the various government assistance packages on offer. There has also been a degree of political pressure applied in some cases. While it is never a good thing to see income decline, in the present circumstances it is understandable. We are focusing on investing in companies that we believe will get through and exit the crisis in good shape and therefore resume dividend payments as quickly as possible.

Amid glimmers that Europe is beginning to see the benefits of social distancing measures, we wish all of our investors and their loved ones well. Please remain safe and take care during this difficult time.