

## Montanaro UK Income Fund

Quarterly Commentary – Q1 2020

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**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 close to its 11<sup>th</sup> 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 18.8% (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. **United Utilities**, the largest listed water company in the UK, benefited from its defensive characteristics. **Primary Health Properties**, the owner of primary health care centres and pharmacies, was rewarded for the security and visibility of cash flows given 90% of rental income is paid by the UK and Irish governments.

The weakest contribution came from **RPS**, the global engineering consultancy, which come under pressure due to expectations of revenue declines and little in the way of balance sheet headroom. **Cineworld**, the leading cinema operator in the UK and US, suffered as cinemas closed across their markets. **4imprint**, the supplier of promotional

merchandise, declined because of potential supply chain disruptions and promotional merchandise budget declines from its core US customer base.

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 asking management about balance sheet stability, 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. According to one analysis, only 40 out of 450 listed companies in the UK have committed to pay dividends this year. 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.

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