Montanaro Better World Fund

Quarterly Commentary – Q2 2020

Market review

Global equity markets recovered sharply during the second quarter of 2020. The strength of this advance was somewhat surprising and seemed at odds with the reality of the most serious pandemic for at least a century: locked down populations; collapsed economies; and mounting death tolls.

At varying stages during the quarter, the economic picture looked particularly bleak: US industrial production registered the largest monthly decline since the Second World War; the Eurozone's PMI indicator fell to an all-time low; and in April, GDP in the UK plummeted by over 20%, the biggest monthly fall since records began. Yet markets continued their upward ascent, so much so that with a degree of political inevitability, Donald Trump felt emboldened to tweet once more about a favourite subject: "*Stock Market up BIG*".

What explained this juxtaposition? A culprit was soon identified, explained, as is so often the case in financial circles, by the use of a pithy acronym: TINA – There Is No Alternative. As the world shut up shop and economies crashed, Governments and Central Banks unleashed an unprecedented level of monetary and fiscal stimulus, estimated at some $15 trillion across the G10 countries plus China. Plummeting interest rates pushed investors into riskier assets that offered a return on their investment. "*Don't fight the Fed*", as the adage goes.

Alongside this, there was some evidence that the green shoots of a much hoped for "V-shaped" recovery were beginning to appear. Retail sales in the UK and US bounced back strongly in May as lockdown restrictions were eased; housing markets picked up; even pubs reopened. These signs, coupled with a report from the IMF suggesting that the second quarter should be the nadir of the Covid-19 economic crisis, were reasons why SmallCap made up ground on its LargeCap peer. The asset class typically reacts with a higher degree of sensitivity to economic news. Improving data meant that over the quarter, Global SmallCap outperformed LargeCap by some 6%.

Portfolio

During the quarter, the NAV of the sterling share class increased by 24%, marginally head of the MSCI World SMidCap Index. Since the beginning of the year, the Fund has outperformed by more than 16%.

The strongest contribution during the quarter came from **Adyen**, the payments platform offering mobile and point-of-sale payments across the world on any device helping to bring connectivity to businesses without access to traditional bricks and mortar banking systems, which benefited from a huge uptick in e-commerce and online payments. **SolarEdge**, the leading photovoltaic inverter helping to transition the world to a Greener Economy, reported a very strong start to the year with Q1 sales up over 58%. **Veeva**, the software provider for life sciences CRM systems as well as clinical systems, saw a boost in demand for some of its products that allowed the life sciences industry to adapt and work through the pandemic.

The weakest contribution came from **Ormat**, the US geothermal power generator, which weakened due to political risk exposure to Turkey, although the company continued to demonstrate attractive rates of growth. **Carl Zeiss Meditec**, the developer of products used to treat eye disease, restore sight and reduce blindness, underperformed as non-essential eye treatments were postponed due to the coronavirus. **Polypipe**, the supplier of recyclable plastic piping systems that are replacing carbon intensive cement alternatives, underperformed after the company issued new shares to further strengthen its balance sheet and to enable continued organic investments.

Outlook

The returns posted by financial markets over the last few months should not disguise the fact that the outlook remains extremely uncertain. The most obvious risk is that the virus has not yet been fully contained; nor has a vaccine been approved, despite promising signs of progress from the University of Oxford, among others. Fears of a second wave are likely to ebb and flow in the months ahead.

It may therefore be premature to extrapolate the returns of the second quarter. Markets may need time to digest earlier gains from a rally boosted by stimulus and investors suffering from "FOMO" (Fear of Missing Out). As we continue to talk to our companies, it is increasingly clear that any recovery is unlikely to be equally felt. Consider the good fortunes, for example, of online retailers who have been able to continue business almost as usual, compared to their long-suffering high-street competitors, whose shops have been closed for several months. As always, there will be winners and losers.

We will continue to only invest in companies that meet both our strict "Quality" criteria – strong balance sheets; good cash flow; run by competent management teams – and those that are able to continue investing in impactful products and services that are aligned with the aims of the UN Sustainable Development Goals. We are heartened by the response of many of our companies to the crisis: they recognise, perhaps more than ever, the pressing need to offer solutions to the world's major problems and run their businesses in ways that are environmentally and socially sustainable. Our selective and conservative approach is, we believe, the best way of ensuring attractive returns from such businesses over the long-term, in a world where short-term uncertainties have seldom been greater.
