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ASSET MANAGEMENT

Montanaro MidCap 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 lock down 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 over the quarter, MidCap in Europe outperformed LargeCap by almost 6%.

Portfolio

During the quarter, the NAV of the share class increased by 17% in Euro terms, 1.4% ahead of the Stoxx Europe Mid 200 index.

The strongest contribution during the quarter came from **Ashtead,** the leading equipment rental business in the US and the UK, which published a reassuring set of results and an upbeat outlook. **Worldline**, one of Europe's leading payments processing companies, benefitted from the acceleration of the 'cash to cashless' trend and also posted a strong set of results. **Hexagon**, the leading global provider of measurement technologies, recovered from a very heavy sell-off in Q1 following better than expected trading.

The weakest contribution came from **CTS Eventim**, the leading provider of ticketing services in Europe, which drifted lower as the ban on holding concerts was extended in Germany. **Kerry Group**, the leading Irish food ingredients company, declined as restrictions on movement will impact the foodservice channel in Q2. **Edenred**, the French prepaid voucher provider, suffered from negative sentiment towards parts of the business affected by the pandemic, including its exposure to Brazil which has had a delayed outbreak of Covid-19.

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 our strict “Quality” criteria: strong balance sheets; good cash flow; run by competent management teams. Our selective and conservative approach is, we believe, the best way of ensuring attractive returns over the long-term in a world where short term uncertainties have seldom been greater.

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