

## Montanaro Select Fund

Quarterly Commentary – Q2 2020

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### 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 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, SmallCap in Europe outperformed LargeCap by over 7%.

### Portfolio

During the quarter, the NAV of the share class increased by 20% in Euro terms, 2% ahead of the MSCI Europe Small Cap benchmark 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. **Fortnox**, the Swedish provider of cloud accounting software, recovered strongly following a sharp sell-off in March, in part due to a relatively upbeat set of results. **MIPS**, the Swedish manufacturer of a brain protecting helmet insert, advanced on greater consumer interests in cycling.

The weakest contribution came from **Smart Metering**, the owner and operator of domestic smart meters, which saw some profit-taking after a good period of performance. **Cranswick**, the leading supplier of fresh pork meat products in the UK, suffered due to uncertainty regarding Covid-19 and Brexit. **CTS Eventim**, the leading provider of ticketing services in Europe, drifted lower as the ban on holding concerts was extended in Germany.

## **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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