Montanaro European Income Fund

Quarterly Commentary – Q4 2020

Market review

When news of a viral outbreak in China's Hubei Province began to circulate at the beginning of the 2020, few could have imagined the global consequences. In the 21st Century, a virus swept across the world, locked down populations, brought economies to a halt and resulted in over 1.8 million deaths.

As Covid-19 spread across borders and achieved pandemic status, it became clear that little could be done to contain the disease. Initially, fear gripped financial markets. Falls in equity prices were so dramatic that it even led to speculation that some indices might be closed to "calm the herd". Ultimately, investors' fears were soothed by a tidal wave of liquidity unleashed by Central Banks and governments: some $15 trillion across the G10 countries plus China. As interest rates declined, investors moved into riskier assets and equities staged a swift and strong recovery.

There were some grounds for optimism. Certain Governments were able to relax lockdown restrictions during the Summer and unlocked economies raised hopes of a "V" shaped return to normality. At Halloween, however, Covid cases spiked again and social-distancing restrictions were re-introduced. Yet financial markets did not panic, for November heralded the arrival of three Covid-19 vaccines with high efficacy rates. The "risk-on" accelerator was pressed once again and much maligned "Value" stocks enjoyed a rare moment in the sun as they led markets higher. Even the US Presidential Election – and Donald Trump's unwillingness to admit defeat – did little to perturb the buoyant mood.

What then, did the score card reveal at the end of 2020? European LargeCap suffered as the continent was ravaged by the virus and factories and shops were shuttered, delivering a poor return of -7%. By contrast, SmallCap delivered a positive return of 3% as the asset class benefited from localised improvements in business activity. This marked the ninth year of outperformance versus LargeCap in the past eleven.

Portfolio

During the quarter, the NAV of the share class increased by 8% (in GBP). For the year as a whole, the NAV increased by 12%.

The strongest contribution during the quarter came from **Avanza**, Sweden's leading online broker and pension provider, which benefited from strong equity markets and continued high trading volumes from retail investors. **Knowit**, the leading digital services provider and Systems Integrator in the Nordic market, had a robust Q3 performance with the market expecting heightened demand for its services in 2021. **MTU Aero Engines**, the aircraft engine manufacturer, outperformed as investors anticipated a return to more normal levels of air traffic following the approval of Covid-19 vaccines.

The weakest contribution came from **Euronext**, the European stock exchange, which underperformed the value rally on little news. **Galenica**, the Swiss pharmaceutical chain, suffered from lower sales from certain high traffic stores which was only partially offset by e-commerce. **Biotage**, the provider of instruments and reagents for the purification of pharmaceuticals, underperformed following disappointment over Covid-related orders.

Outlook

Many are glad that 2020 is over, a year in which life for billions of people was turned upside down. Yet things may not be much different in 2021, at least for a few months. Further lockdown restrictions have been announced due to a more virulent strain of the Covid-19 virus. For now, the virus is calling the shots, continuing to threaten our health, economies and freedom.

However, the rollout of vaccines should allow a return to greater normality, hopefully by the Summer. What world will we face then? There will be a monumentally large debt burden as Government support during the crisis has been unprecedented. Therefore, this era of extraordinary monetary policy is likely to continue. Sustained low interest rates would allow the economy to recover, perhaps quite strongly, once the battle against the virus is perceived to be won.

From an equity perspective, this may mean that heavily stressed companies that have suffered the most lead an initial rally in markets. This would benefit "Value" companies as we saw last November. We would, however, urge a note of caution to those who believe that 2021 will be the year that low quality companies outperform. Once Covid-19 is behind us, consumers may shift uneasily between exuberance that their freedoms have been restored and nervousness about the future, particularly for those working in industries that have been structurally changed by the last few months. It may not be time to throw caution to the wind.

We will continue to invest in the highest quality companies that we can find, for, in our view, these will be the long-term winners. Many of our companies can look forward to exciting futures: healthcare businesses responding to the need for better preventative solutions and greater demand for new forms of treatment; technology companies creating a more connected, digital and safer on-line world; companies with strong management teams who have looked after their employees during this crisis and have emerged stronger; and those doing their bit to tackle important global issues such as climate change.

We wish you and your families good luck and every success in the months ahead. Stay safe, happy, and hopeful for a prosperous future and a return to normal.

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