MONTANARO
ASSET MANAGEMENT

# Montanaro UK 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? For SmallCap investors, it was another year in which the asset class outperformed its LargeCap counterpart. UK LargeCap stocks suffered their worst annual performance since 2008, falling by some 14%. Of the UK's equity markets, however, only the smaller company focused AIM Index posted a positive return in 2020 (a healthy 21%). As well as the economic consequences of Covid-19, Brexit continued to be a drag on UK equities until a deal was at last struck with the European Union on Christmas Eve.

## Portfolio

During the quarter, the NAV of the share class increased by 13% as investors responded to positive vaccine news and a belief that a Brexit deal of some kind would emerge. Over the year as a whole, however, the NAV declined by 6%.

The strongest contributions during the quarter came from **Vistry** and **Taylor Wimpey**, the housebuilders, which performed strongly following the vaccine announcement and after both companies issued positive trading updates. **NCC Group**, the cybersecurity services company, enjoyed a strong Q4 following a positive trading update that demonstrated robust year-on-year growth.

The weakest contribution came from **James Fisher**, the marine services provider, which announced a deterioration in activity during Q3. **Pennon**, the water utility, underperformed the broader market as it has relatively less to gain from the positive vaccine news. **Hilton Foods**, the leading food packer, underperformed a rallying market after reporting Q3 performance in line with management expectations.

**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. Furthermore, given our focus on investing in companies with strong balance sheets, we expect the dividend outlook for 2021 to be much rosier than 2020.

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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