Montanaro European Income Fund

Quarterly Commentary – Q1 2021

Market review

The impact of "Pfizer Monday" continued to be felt in the first quarter of 2021. This harks back to Monday 9 November 2020, when Pfizer and BioNTech announced the first effective Covid-19 vaccine, a *"great day for science and humanity".* It was also a good day for investors in those businesses which had suffered most from the economic consequences of Covid-19. It unleashed the most dramatic rotation in equity markets in living memory. Value and Low Quality bounced back strongly at the expense of Quality and Growth, a dynamic that continued unabated in Q1.

As an indicator of how extreme this rotation has been, in the UK, SmallCap Growth has underperformed Value by 24% since November 2020, which compares to a c.30% underperformance experienced in both 2009 and 2013. To add weight to this view, a recent survey published by Bank of America suggests that, by mid-March, most Fund Managers were overweight Cyclicals and Commodities with the largest underweight in Technology since the start of the Bull Market in 2009.

Given our "Quality Growth" style, unsurprisingly we have underperformed since last November. We avoid highly cyclical areas such as high street retail, restaurants, hotels, airlines, oil & gas, materials, metals & mining etc. which helped us going into Covid. These same lower quality "Value" companies have bounced back sharply in recent months. We never like to disappoint you and do not enjoy such periods of underperformance, even if our Funds are holding up in absolute terms. Our investment approach will continue to remain consistent.

Portfolio

During the quarter, the NAV of the share class declined by 1.5% (in GBP).

The strongest contribution during the quarter came from **Thule**, the manufacturer of sports and outdoor goods, which continued to benefit from "staycation" trends. **NCAB**, the full-service supplier of PCBs, rose after reporting strong Q4 results and reinstating dividends. **Atea**, the leading provider of IT infrastructure solutions in the Nordic and Baltic region, gained as investors continued to anticipate strong growth.

The weakest contribution came from **Knowit**, the Nordic IT consultancy and systems integrator, which experienced profit taking. **Nolato**, the contract manufacturing of silicon and plastic moulded devices and components, traded lower following a weaker than expected set of results. **Fjordkraft**, the Norwegian power company, softened as investors digested recent M&A activity in Sweden and Finland.

Outlook

Certain countries are taking steps along the pathway to normality, with the reopening of pubs being a particular cause for celebration in the UK (even if this has coincided with a blast of snow – the British weather never fails to disappoint). The reopening of economies has led to expectations that the recovery will be accompanied by increased levels of inflation. This has resulted in a steep rise in the risk-free rate, as seen through the US Government 10 year bond yield. Towards the end of the quarter, however, bond yields started to fall, suggesting that the sharp moves we have seen in financial markets may be slowing.

In a recent *"Letter to Investors"*, we urged our clients to remain calm in the face of the market rotation that has occurred. This is a message that we reiterate here. Style rotations are typical of the recovery period that comes immediately after a Bear Market - think of March 2003, March 2009 and 2012/13. Fortunately, these rotations tend to be short-lived. We have lived through several such periods before - after all, Montanaro is celebrating its 30th anniversary this year. Today, we are more convinced than ever that investing in high quality, small growth companies with strong management teams will deliver strong returns over any medium term period.

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