

Montanaro UK Income Fund
Quarterly Commentary – Q2 2021**Market review**

For the English, football did not come home this summer. Instead, 2021 will be added to the years of hurt: red cards, metatarsals, the Hand of God, WAGs and yet more penalty heartbreak. For those not interested in the fortunes of the England football team, the first half of the year may also be remembered for something a little more relevant to the investment world. It's not coming home...but the money is!

After years of steady outflows from domestic UK equities, the tide seems to have turned. In the decade to the end of 2020, over £600 million was withdrawn from UK SmallCap funds, according to the Investment Association. Since the beginning of 2021, over £700 million has come back to the asset class, an indication that on a global basis the UK looks attractive as the economy reopens and the overhang of Brexit fades.

The Value rally, which has been the dominant force in equity markets since the approval of Covid-19 vaccines last November, cooled in the second quarter of the year. Equities traded higher as confidence in the economic recovery was bolstered by accelerating vaccination programmes. Europe made particularly good progress, catching up with high vaccination rates in the US and UK. SmallCap continued to benefit from the gradual unlocking of the economy and at the half-year mark, had outperformed LargeCap by 8%.

Portfolio

During the quarter, the NAV of the share class increased by 11% and is now outperforming the FTSE All-Share by 3% since the beginning of the year.

The strongest contribution came from **DiscoverIE**, the designer and manufacturer of components for electronic applications, which saw record order book growth following a faster-than-expected recovery from the pandemic. **Big Yellow**, the market leader in the self-storage sector, benefited from a strong set of results. **NCAB**, the full-service supplier of PCBs, experienced strong order growth thanks to a recovery in its end markets and customers stocking up to avoid semi-conductor shortages.

The weakest contribution came from **Taylor Wimpey**, the housebuilding company, which saw profit taking after a good Q1 as housing demand in the UK remained high. **James Fisher**, the UK marine services provider, traded lower as investors waited for the conclusion of the company's strategic review. **Ricardo**, the technical consultant for the auto and environmental industries, experienced mild volatility in its share price as investors waited for the appointment of a new CEO.

Outlook

At the beginning of April, we published a “*Letter to Investors*” in which we urged clients to remain calm in the face of a strong value-led market rotation. Guided by history, we suggested that such style rotations tended to be short-lived. This proved fortuitous timing – the Value style has since lost some of its momentum. This illustrates quite how difficult it is to time markets. Rotations, when they happen, tend to be swift.

We are moving into uncharted territory in the battle against Covid-19 with the ending of social and economic restrictions in some countries. Many people are likely to experience a mixture of emotions: relief that the pandemic may be coming to an end, contrasted by worries that cases will rise or that new variants of the disease will emerge. It would be no surprise if these anxieties manifested themselves in greater market volatility during the second half of 2021.

A catalyst for volatility could be that as economies reopen, inflation rises faster as pent-up demand is released. It is our view, however, that it will take a lot for central banks to bring to an end this long period of loose monetary policy. Whichever way the macroeconomic winds blow, we will continue to search for businesses with quality foundations that can grow over time and compound returns to their shareholders.

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