

Montanaro UK Income Fund**Quarterly Commentary – Q3 2021**

Market review

As so often seems to be the case, investors returning from Summer holidays found plenty to worry about. An energy crisis, blockages in global supply chains, a slowdown in China and growing inflationary pressures were just some of the things to ponder. Rising energy and commodity prices, increased shipping costs (which have gone up tenfold in the space of a year) and labour shortages fed through to staple products, with global food prices hitting a ten-year high. Bond yields rose as some Central Bankers switched from dovish to hawkish mode. If there was good news to be found, it was that, for the first time in many months, Covid-19 was not the dominant factor influencing equity markets.

While many developed market indices were flat over the quarter – September’s worries eroding the gains of the earlier Summer months – it was a good period for SmallCap, which held its ground and continued to outperform its LargeCap counterpart. While our strategies enjoyed a quarter of healthy outperformance, inflationary pressures contributed to a sell-off of Growth stocks relative to Value towards the end of the period.

Portfolio

During the quarter, the NAV of the share class increased by 6%, outperforming the benchmark by 3.3%.

The strongest contribution came from **Kainos**, the provider of digital transformation services primarily to the UK Government, which rose on continued confidence in demand for its services, both in the public sector as well as through its partnership with Workday (a US-listed software provider). **FDM**, the provider of IT professionals, performed strongly on the back of an upbeat half year report, citing strong demand across all regions. **NCAB**, the full-service supplier of PCBs, gained as a result of the well-publicised supply and demand dynamics in the semiconductor space, as well as its announcement of the acquisition of RedBoard Circuits in the US.

The weakest contribution came from **NCC**, the cyber security business specialising in software escrow and cyber services, which posted an underwhelming set of results which led to some doubts about the speed of its projected growth acceleration. **TI Fluid Systems**, the auto parts supplier, traded lower due to the persistent chip shortages. **XP Power**, the provider of power solutions, weakened as the company faces tough comps in its medical division in Q3.

Outlook

The fizz appears to have gone out of equity markets. While September and October have historically been tricky months for investors, a period of consolidation may be no bad thing. Equity investors, who have had plenty to cheer about in recent years, are sitting on double-digit gains in most developed markets so far in 2021.

As we write these lines, the style rotation into Low Quality and Value is intensifying. The current environment reminds us of the price action seen in the weeks that followed the announcement of the Pfizer vaccine in November 2020, albeit the rotation is not as dramatic. Fortunately, these periods tend to be short-lived. We will keep our heads down and carry on investing in the same way as always – with our “Quality Growth”, Buy & Hold hats firmly on.

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