MONTANARO
ASSET MANAGEMENT

# Montanaro Better World Fund

**Quarterly Commentary – Q4 2021**

## Market review

A "Santa Rally" capped off another good year for equity investors in 2021. This, despite the threat of the Omicron variant which worried financial markets in the lead-up to Christmas and led to heighted levels of price volatility. Investors across almost all geographic markets enjoyed positive equity returns for the year, with only the New Zealand and Hong Kong indices posting negative returns – New Zealand suffering from its extended covid lockdown and Hong Kong a victim of political instability. In Europe, almost every sector posted healthy returns, the leader being IT while the laggard was retail, the only area of the market to post negative returns for the year.

To some extent the strength of returns was surprising given the numerous issues that threatened the economic trajectory: supply chain bottlenecks; labour shortages; and rising inflation. Indeed, during the fourth quarter, inflationary pressures overwhelmed a strong earnings season, leading to the underperformance of SmallCap versus LargeCap, while Growth stocks significantly lagged Value.

It was also a busy quarter on the sustainability front. We continued to co-chair the **B Corporation "Finance & Investment Working Group"** and were part of a delegation of companies that attended COP26. We also contributed to the **Glasgow Financial Alliance for Net Zero (GFANZ)**, chaired by Mark Carney, UN Special Envoy on Climate Action and Finance. We are part of the "Real Economy Transition" taskforce, working to align standards around climate reporting and roadmaps to Net Zero. Before Christmas, we also finalised our latest **Net Zero Carbon report** and **Data Centres Deep Dive**, which we will soon be sharing with our clients.

## Portfolio

During the quarter, the NAV of the sterling share class increased by 4.9%, an outperformance of 1.6 % versus the MSCI World SMidCap Index. For the year, the NAV rose by 20%, a healthy outperformance of over 2%. This is the fourth year in succession that the Fund has outperformed.

The strongest contribution during the quarter came from **NOVA**, the supplier of advanced metrology equipment for semi-manufacturers, which rose after reporting strong Q3 results, the expansion into advanced chemical metrology with the acquisition of Ancosys and the launch of METRION, a new technology. **TREX**, the world's largest manufacturer of wood-alternative decking and railing products, performed well following a strong trading period during the third quarter. The results were ahead of consensus expectations with a strong outlook for Q4. More importantly, the company announced robust guidance for 2022 with strong double-digit revenue growth. **ICON**, Europe's largest CRO for biopharma clinical trial services, had an excellent quarter following positive newsflow on biotech funding and signs of a successful integration with PRA, one of its largest competitors.

The weakest contribution came from **Renova**, the Japanese renewables company, which announced on Christmas Eve that it was unsuccessful in the Yurihonjo Offshore Wind project auction, which led to a steep sell-off in the shares. We have since spoken to management and our holding, which we had reduced before this news, is under review. **Chemometec**, the Danish provider of instruments to enable the quality control of cell therapies, underperformed despite strong operating performance along with the wider sell-off in high growth healthcare companies. **Ryman Healthcare**, the builder and operator of retirement villages and care homes in New Zealand, traded lower as the sector remains out of favour in the current pandemic environment.

**Outlook**

There is a seasonality effect to markets and 2022 has started as it so often does, with the underperformance of Growth versus Value. The predominant reason for this has been a continuation of inflationary fears – indeed inflation in the US has reached a 40-year high. On this point we will only reiterate what we have said before: we are not economists and do not spend too much time worrying about the macro. We focus on the quality, impact potential and growth opportunities of our individual companies and construct the Portfolio on a bottom-up basis.

That said, clients have recently been asking us about the potential impact of inflation and interest rates on the Fund, so here are a few thoughts. The first thing to note is that the SmallCap effect has held true throughout periods of both rising and falling interest rates and during all but galloping inflationary environments (>12%); so we are convinced that investing in Smallcap makes sense, no matter how the macro winds are blowing.

Secondly, the balance sheet strength of the companies in the Portfolio significantly reduces refinancing risk from rising interest rates. Our focus on Quality should mean that our companies are relatively well placed to deal with higher rates of interest. Indeed, one of the key attributes we look for when assessing Quality is pricing power – the ability to pass on cost increases to customers. While there is no doubt that inflation and supply chain disruptions are having some impact on operations, we feel that the companies in the Fund are relatively well placed to deal with these challenges.

We are looking ahead with excitement. As we mention in our Net Zero Carbon report, there is a pressing need for companies and investors to *"hurry up and get on with it"* – to take the momentum from COP26 and ensure that action to mitigate and adapt to climate change and other major world issues is as rapid and sustainable as possible. Significant growth tailwinds exist to support this action. The companies that grasp these opportunities should be able to deliver significant impact and value to their various stakeholders.

We wish all of you a very Happy New Year and every success in 2022!

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