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ASSET MANAGEMENT

Montanaro Global Innovation 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.

Before Christmas, we also finalised a **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 2%, an underperformance of 1.2% versus the MSCI World SMidCap Index. For the year, the NAV gained by over 22%, a healthy outperformance of 6.9%.

The strongest contribution during the quarter came from **SiTime**, the provider of silicon-based timing solutions, which gained after posting very strong growth in Q3. **NOVA**, the supplier of advanced metrology equipment for semi-manufacturers, 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. **Endor**, the German producer of high end steering wheels and other peripherals for gaming, outperformed slightly on no particular news.

The weakest contribution came from **Everbridge**, the leading provider of critical event management software, which declined after its CEO unexpectedly resigned and they announced 2022 guidance marginally behind consensus expectations. **TransMedics**, the US provider of instruments for facilitating greater utilisation of organs for transplants, underperformed due to slower than expected growth of its lung transplant business, which has been negatively impacted by Covid-19. **Sinch**, the global leader in communication APIs, saw its shares derate off a high multiple following market concerns about its ability to execute ambitious M&A integration plans.

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 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 means that in comparison to our index, the Portfolio companies are better equipped to handle both higher interest rates and inflation. Their balance sheet strength, with most in net cash positions, means that any refinancing risk is very low. Meanwhile their pricing power as market-share leaders, typically with very high IP and product differentiation, means that they are able to pass on inflationary costs to their customers, protecting their top lines. On the supply side, our companies have extremely low exposure to inflation in material costs and shipping costs compared to their index, which protects their bottom lines and capital return profiles also.

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

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