

Montanaro MidCap FundQuarterly 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 heightened 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 MidCap versus LargeCap, while Growth stocks significantly lagged Value.

Portfolio

During the quarter, the NAV of the share class increased by 7.1% in Euro terms, 3.6% ahead of the Stoxx Europe Mid 200 index. For the year, the NAV increased by 26.9%, an outperformance of over 10%.

The strongest contribution during the quarter came from **Autotrader**, the UK’s largest online second-hand car marketplace, which rose after announcing strong H1 results with record six-monthly revenue and profits. **Moncler**, the Italian apparel manufacturer and lifestyle brand, staged good growth with the addition of Stone Island and continuing consumer demand for Genius and its recycled garment line. **IMCD**, the global distributor of specialty chemicals, continued to post strong performance amidst brisk demand growth, M&A and inflationary price increases.

The weakest contribution came from **Sinch**, the global leader in communication APIs, which saw its shares derate off a high multiple following market concerns about its ability to execute ambitious M&A integration plans. **Worldline**, the European leader in payments processing, underperformed as Q3 lockdowns heavily impacted its core European business. **Edenred**, the specialist payment solutions business, was also impacted by the reimposition of Covid-related restrictions in Europe.

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 smaller companies have performed well throughout periods of both rising and falling interest rates and during all but galloping inflationary environments (>12%); so we are convinced that investing in our asset classes 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. Finally, for the sectors that will likely be more susceptible to inflation, such as the housebuilders, industrials and consumer sectors, our focus on Quality should mean that our companies are relatively well placed to deal with it. 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 wish all of you a very Happy New Year and every success in 2022!

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