Montanaro European Income Fund

Quarterly Commentary – Q1 2022

Market review

After a difficult start to the year, our Funds stabilised in March, outperforming their respective benchmarks. Clearly, this was not enough to offset the underperformance experienced in January, but it was a sign that investors' enthusiasm for Low-Quality Value stocks may be waning.

It has been a painful quarter for Quality Growth managers like us. Our Funds recorded one of the worst months ever in relative terms in January. The reason for this was a dramatic style rotation from Growth to Value, one of the fastest that we have witnessed in over 30 years of managing Small & MidCap portfolios. The swift change in sentiment was due to a burst of global inflation, which stoked fears of interest rate rises and disproportionately hurt long duration assets, notably Growth Small & MidCap equities. To put things in context, the MSCI World Growth index underperformed its Value counterpart by a staggering 8.1% in January, the second largest such underperformance in almost 50 years (only topped by April 1999, when Value enjoyed a brief respite amidst the dot-com frenzy).

The outperformance of Value continued in February, albeit not with the same vigour as we had seen earlier in the year. While inflation remained a dominant theme, another far more serious moment of historical significance impacted markets on 24 February 2022. Russia launched the largest military attack in Europe since World War Two by invading Ukraine, further shaking the confidence of equity investors. None of our Funds has ever had (or will have) direct exposure to Russia or Eastern Europe.

Portfolio

During the quarter, the NAV of the share class declined by 13% (in GBP). Much of this decline came in January and it was reassuring to see the NAV rise in March.

The biggest contributors to performance in Q1 were **GTT** (+49bps) which provides technology for LNG storage and transportation, **Edenred** (+42bps) which provides voucher payment schemes, and **Brenntag** (+32bps) which is a global chemicals distributor. The biggest detractors were **Thule** (-152bps) which makes outdoor activity related goods, **Nolato** (-141bps) which is a contract manufacturer of plastic components and casings, and **NCAB** (-120bps) which is a contract supplier of PCBs. It is notable that Swedish and Norwegian stocks fared particularly poorly in Q1, which we think may have been exacerbated by their proximity to Russia.

During the quarter we replaced two positions. We sold **Biotage** amid growth concerns on some key product lines and its high valuation, and **Bakkafrost** given the significant challenges of their salmon farming operations. In turn we made new purchases in **Brenntag** and **Bouvet** which is a high-quality tech consultancy in Norway. Trading was otherwise kept to a minimum during the quarter, with the exception of **NCAB**, which had become a very large position in the fund following strong growth in 2021, and **Knowit**, where we think operational conditions have become more challenging.

Outlook

In times of market turbulence, it is easy to get distracted by the noise of headlines. There have been many such distractions over the quarter, from worries about inflation to sombre updates from Ukraine. Against such a backdrop, we have been focusing as always on our companies and understanding how they are impacted by the pressures impacting the global economy. On the whole, the message has been reassuring. Many companies have posted positive trading updates and some have come in ahead of consensus expectations. The environment has allowead us to invest in and add to companies whose valuations have fallen due to negative sentiment, rather than a deterioration in the underlying fundamentals.

Regarding dividends, we have now had around 80% of our expected dividends announced, subject to AGM approvals. On aggregate these have come in slightly better than our original forecasts albeit with a range of outcomes. There has been a notable trend of esp. industrial companies distributing less dividend than forecast, often because of tight supply chains and the need to invest in working capital or simply to approach 2022 with some conservatism. Notable examples were **Atea**, **Beijer Alma**, **Kitron** and **Thermador**. Pleasingly, this has been compensated by some better-than-expected distributions from strong 2021 performers. Examples include **Borregaard** (which announced a special dividend), **Amadeus FiRe**, **Avanza** and **Loomis**. Overall, we now forecast a total dividend of 5.75p, which is 4.5% higher than our original forecast of 5.50p in January.

Finally, it is worth noting that the entire Montanaro team invested additional capital in our Funds in Q1. We are aligned with our clients and share the ups and downs of markets with you.

As well as the investment implications of the Ukraine conflict, MAM is acutely aware of the human suffering that is occurring. In response to this, our team has collectively made a contribution to the 'Disaster Emergency Committee – Ukraine Humanitarian Appeal'. This contribution has been matched by MAM, providing a significant donation *to help people affected by this escalating conflict. More information about this appeal can be found here: https://www.dec.org.uk/appeal/ukraine-humanitarian-appeal*
