MONTANARO
ASSET MANAGEMENT

Montanaro Global Innovation 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 sterling share class declined by 18%, an underperformance of 14% versus the MSCI World SMidCap Index. Much of this underperformance came in January and it was reassuring to see the NAV rise in absolute terms in March, ahead of the benchmark.

The strongest contribution during the quarter came from **SolarEdge**, the leading photovoltaic inverter supplier, which rose after reporting strong demand as the Russian invasion of Ukraine furthered interest in renewable energies. **TransMedics**, which sells equipment used to transport and assess organs prior to transplantation, performed well off the back of a strong start for their newly approved heart and liver products in the US. **Photocure**, which sells a drug used to help diagnose and treat bladder cancer, gained following a key regulatory approval for their partner Karl Storz.

The weakest contribution came from **Esker**, the French provider of cloud software solutions that help companies to manage working capital, which weakened during the quarter as it was caught up in the sell-off of high growth tech companies, while increased investments reduced margin expectations. **Oxford Nanopore**, the global leader in long-read gene sequencing instruments, saw its share price sell off in line with other long duration growth stocks, after a very strong run following the IPO. **Ambarella**, the computer vision chip designer, weakened after guidance for Q1 was impacted by persistent supply chain challenges.

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.

Innovative companies with high IP are in a strong position to grow through economic cycles, whilst their intangible-asset based business models typically translate into cost structures that are less sensitive to inflation than the companies in their index, which will likely see pressure on their gross margins, as well as operating margins.

Portfolio companies are sending us the message that they are seeing no deceleration in their structural growth drivers. Many companies have posted positive trading updates and indeed most have come in ahead of consensus expectations. Portfolio companies in certain Innovation sectors like Cyber Security, and the Life Sciences Research sectors, are communicating to us that their end-markets are seeing even more heightened demand than last year.

It is also noteworthy that current geopolitical commentary since the present tensions between NATO, Russia, and China, is underscoring the strategic importance of home-grown innovation and IP in Western economies, which, in pursuit of greater technological autonomy, are encouraging heightened investment in strategically important Innovation themes, from Artificial Intelligence to Healthcare.

It is pleasing that this environment has allowed us to invest in and add to companies whose valuations have fallen due to negative sentiment, rather than a deterioration in the underlying fundamentals.

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

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