

Montanaro UK Smaller Companies Investment Trust
Quarterly Commentary – Q1 2022**Market review**

After a difficult start to the year, the Portfolio stabilised in March, outperforming its respective benchmark. 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 strategies 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.

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 Trust declined by 19.5%, an underperformance of 9.9% versus the benchmark index. Much of this was due to the very rapid style rotation to Value stocks that occurred in January. The NAV was flat versus the benchmark in March.

The strongest contribution during the quarter came from **M.P. Evans**, the producer of sustainable palm oil, which benefited from continued strength in crude palm oil prices and significant crop growth, with FY21 revenues up 59%. **Hilton Food Group**, the food packaging business, released a strong set of results for FY21 with sales growth of 19% and resilient margins. **Tracsis**, the provider of software and consulting services to transportation markets, traded well on the back of a robust trading update.

The weakest contribution came from **Kainos**, the provider of digital transformation services primarily to the UK Government, which weakened as it was caught up in the general sell-off of high growth technology stocks. **LionTrust**, the asset manager,

traded lower due to financial market weakness. **Auction Technology Group**, the online auction platform for industrial, agricultural and construction machinery and arts & antiques, also declined due to general weakness in technology names.

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 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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