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ASSET MANAGEMENT

Montanaro Better World Fund

Quarterly Commentary – Q2 2022

Market review

This has been the worst first half of a year for developed market equities in over 50 years. To make matters worse, there has been no hiding place: government bonds and cash, usually safe havens, have been hit by higher interest rates and rising inflation. Central banks have struggled to deal with an inflationary environment, even as they have brought to an end the long era of "easy money" that has been in place since the Global Financial Crisis. It seems the adage rings true: one crisis leads to another.

For Quality Growth investors, this has resulted in an extremely tricky period, to say the least. The threat of higher interest rates has stalked markets, leading to a significant de-rating of growth stocks – businesses for whom future earnings are vulnerable to higher interest rates. Consumers have faced a significant increase to the cost of living and recessionary fears have heightened.

Although some may have anticipated a marked underperformance of SmallCap versus LargeCap (as is historically typical during periods of market stress), on a global basis, SmallCap has held up relatively well. On a more localised basis, however, the underperformance of the asset class has been far more pronounced: in the UK, SmallCap has underperformed LargeCap by 19% so far this year, while on the Continent it has underperformed by 11%. This, however, is explained not so much by investors' aversion to smaller companies, but by the make-up of index constituents. In both the UK and Europe, the best performing sector has been Energy, an area of the market dominated by LargeCap names.

Portfolio

During the quarter, the NAV of the sterling share class declined by 17%, an underperformance of 7%. As recessionary fears increased in June, there were signs that Quality was returning to favour, with the Fund outperforming on a relative basis, a trend that has continued so far in July.

The strongest contribution during the quarter came from **Bruker**, the leading developer of scientific instruments for use in life sciences and materials R&D, which performed well as its end-markets are viewed as robust. **Idexx Corp**, a US engineering specialist whose products helps to keep people safe in extreme environments, benefited from solid end markets**.** **Veeva**, the global leader in cloud software for biopharma companies, saw its share price perform better given the strength of its market share and the relative security of its customers' budgets, coupled with excitement about new product releases.

The weakest contribution came from **Cognex**, the leading provider of machine vision systems, which declined after publishing a cautious outlook for the second quarter. **MIPS**, the Swedish manufacturer of a brain protecting helmet insert, weakened due to continuing concerns on consumer spending in an inflationary environment, despite increased 2027 sales guidance. **ZScaler**, the global leader of innovative cyber security software in zero trust network protection, suffered a derating in line with every other long-duration, high-growth company, despite strong fundamentals.

Outlook

While the outlook remains uncertain, the significant decline in equity prices has shifted the risk / reward balance. Equities have significantly de-rated, particularly those in the Quality Growth part of the market. The Better World Fund now sits on forward valuation of 20x, based on our estimates, almost half of what it was a year ago. Even if, as seems likely, developed markets enter recessionary territory, selling stocks now and buying them back cheaper at a later date is a game fraught with risk. It is also worth noting that while Value has significantly outperformed Growth so far this year, Value based indices have still posted negative returns.

We believe that the strong outperformance of Value versus Growth may now be behind us. In an uncertain economic environment, the Quality companies that we favour – those that are highly profitable, with sound fundamentals, plenty of cash on their balance sheets and good management teams – remain attractive for long-term investors.

The Better World Fund invests in companies with such characteristics that are, we believe, exposed to the most exciting investment opportunities of this generation. The transition from the “old world” – of fossil fuels, energy intensive manufacturing, unequal healthcare systems – to a “new world”– built by companies whose products offer better outcomes for people and the planet, is an unstoppable force.

We thank you all for your continued support during this difficult six months and look forward to meeting with you again in the coming weeks and months.

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