Montanaro MidCap 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 whose valuations are sensitive to the time-value of money. 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 share class declined by 15.4% Euro terms, 1.3% behind the Stoxx Europe Mid 200 index. As recessionary fears increased in June, there were signs that Quality was returning to favour, with the Fund outperforming on a relative basis.

The strongest contribution during the quarter came from **Edenred**, the specialist payment business, which benefitted from expectations that it will prove resilient in an uncertain economic environment. **SimCorp**, the system provider for asset managers, traded up following solid quarterly results and some contract win announcements. **Temenos**, the market leading provider of cloud-based banking software, saw its shares rise following rumours of private equity takeout interest.

The weakest contribution came from **Ashtead**, the leading equipment rental business, which weakened amid growing concerns of an economic slowdown. **ASM**, the supplier of advanced deposition equipment for semiconductors, weakened as investors worried about an economic slowdown. **Thule**, the manufacturer of sports and outdoor goods, continued its decline as consumer discretionary spending suffered given rising inflation.

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. 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. 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.