LF Montanaro Global Select Fund

Quarterly Commentary – Q3 2022

Market review

Equity markets declined in the third quarter, despite a strong rally in July. Leading Central Banks reiterated their determination to control inflation in August and September, leading to a sharp rise in bond yields and a sell-off in equites. Hikes during the quarter included rises of 1.5% from the Federal Reserve, 1.25% from the European Central Bank and 1% from the Bank of England as central banks played catch up with inflation.

Thankfully, certain global inflationary pressures began to moderate. The West Texas Intermediary (WTI) has dropped nearly 30% since the beginning of July, while the FAO Food Price Index fell for the sixth consecutive month. Nevertheless, consumers remain under pressure (particularly homeowners in the UK seeking to re-mortgage after the government's "mini-budget").

The market reaction to this backdrop has been extraordinary. As we show in our latest *"Outlook for Global Small & MidCap"*, all major asset classes bar oil have lost investors money so far this year. The S&P 500 suffered its second worst September in 30 years and is on track for one of its worst years, in real terms, since 1872. It was a better quarter for Global SmallCap, however, which outperformed LargeCap for the first time since Q1 2021.

Portfolio

During the quarter, the NAV of the Sterling Accumulation Share Class increased by 2.2%, in line with the MSCI World SMidCap Index.

The strongest contribution during the quarter came from **XPEL**, the leader in protective films across automotive and architectural applications, which traded up following strong quarterly results. **Paycom**, the US provider of payroll software, performed well as the company continued to deliver strong growth numbers and employment levels at their customers has remained high. **Tecan**, the leading Swiss provider of robotic instruments for life sciences research and diagnostics, performed well as confidence increased in its organic growth outlook, which should prove resilient in a recessionary environment.

The weakest contribution came from **Medistim**, the Norwegian provider of medical equipment used to increase the safety of heart bypass surgeries, which underperformed despite continuing to deliver strong underlying growth, especially in the US. **Chemometec**, the Danish provider of quality control instruments used in the cell & gene therapy industry, sold off in September following a premature disclosure of management's expectations for next year. We have engaged with the Board of Directors on this issue and have provided advice on governance procedures and disclosures going forward. **Games Workshop**, the British manufacturer of miniature wargames, traded lower on weaker consumer sentiment.

Outlook

It now seems a matter of "when" not "if" developed markets enter a recession. In some respects, investors just want economies to *get on with it* so that a recovery can begin. This uncertainty, coupled with the de-rating that we have seen in equity markets, at least means that valuations have become more attractive.

Indeed, across the world equity valuations have fallen below their 25-year averages. Even in the US, the market is currently trading on a P/E ratio of 15.6 versus a long-term average of 16.6, while US SmallCap is on a lower P/E than during the Great Financial Crisis of 2008. Global SmallCap is on its lowest P/E in more than a decade and it has never been this cheap relative to the market. In Europe, SmallCap is close to its largest discount to LargeCap in almost twenty years. Of course, these valuations are based on current consensus analyst forecasts for earnings growth, which are gradually being revised down as the global economy cools. Nevertheless, it is clear to us that value is returning to equity markets. Given we are facing a cyclical economic slowdown, not a systemic financial meltdown as in 2008, investors may find that they start to feel a little braver in the final months of the year.

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