

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 equities. 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, although within Europe SmallCap continued to lag.

Portfolio

During the quarter, the NAV of the Trust declined by 10%, an underperformance of 3.4% relative to the MSCI Europe SmallCap (ex UK) Index.

The strongest contribution during the quarter came from **Tecan**, the leading Swiss provider of robotic instruments for life sciences research and diagnostics, which performed well as confidence increased in its organic growth outlook. **Sartorius Stedim Biotech**, the provider of equipment used in the production of biologic drugs, rose as the company announced the acquisition of UK-based Albumedix. **Brunello Cucinelli**, the Italian luxury maison, continued to outperform on the back of solid results and a strong wholesale network, with 15% sales growth expected in 2022.

The weakest contribution came from **Amadeus FiRe**, the leading specialist recruitment business in Germany, which was affected by a disorderly return by local authorities to pre-pandemic government training support schemes. **MIPS**, the Swedish manufacturer of a brain protecting helmet insert, underperformed as the company noted softness in the biking sector in a trading update. **Medistim**, the

Norwegian provider of medical equipment used to increase the safety of heart bypass surgeries, underperformed despite continuing to deliver strong underlying growth, especially in the US.

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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