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ASSET MANAGEMENT

Montanaro Better World 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. The era of loose monetary policy that has been in place since the Global Financial Crisis is well and truly over. 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 remortgage 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 (pity the Bitcoin owners down almost 60%). The S&P 500 suffered its second worst September in 30 years and incredibly 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. As investors reacted to slowing economic growth, "Quality Growth" companies returned to favour, outperforming those businesses more at risk from a recession.

Portfolio

During the quarter, the NAV of the sterling share class rose by 4%, an outperformance of 2%, due to the Portfolio's focus on owning companies with strong quality fundamentals and strong long-term growth prospects.

The strongest contribution during the quarter came from **Advanced Drainage Solutions**, the leading provider of high-performing stormwater management solutions, which rose after reporting record results ahead of market expectations on the back of strong demand across all construction end markets. **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. **Ameresco**, the renewable and energy efficiency company, performed well in the quarter after reporting a strong Q2 and issuing a positive update on its large battery project with SoCal Edison, which is expected to complete by the end of the year.

The weakest contribution came from **Chr Hansen**, the Danish science based natural solutions provider, which weakened as delays in passing on price increases lead to narrower FY organic growth guidance. **Catalent**, the leading Global CDMO for Biologics Drug Products, saw its shares perform poorly after lowering guidance for Covid vaccine production, alongside unfavourable FX exposure. **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.

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 and we remain excited by the structural growth themes the companies in the Better World Fund are exposed to as capital continues to transition to more sustainable areas of the economy. Given we are facing a cyclical economic slowdown, not a 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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