MONTANARO

ASSET MANAGEMENT

Montanaro European Income 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.

The market reaction to this rate-hiking cycle 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 currently on track for one of its worst years, in real terms, since 1872.

Thankfully, certain global inflationary pressures have begun 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 as they struggle with higher costs for food, energy and housing. Against this backdrop it was, unsurprisingly, a tough quarter for European smaller companies, which are sensitive to fears of recession.

Portfolio

During the quarter, the NAV of the Sterling Share class declined by 8% (in GBP).

The strongest contribution during the quarter came from **Loomis**, the provider of cash management services in more than 20 countries, which performed well on back of a strong US dollar and continued positive activity during the summer. **Moncler**, the Italian apparel manufacturer and lifestyle brand, outperformed on the relaunch of its iconic Maya jacket in celebration of the company's 70th anniversary. **Hufvudstaden**, the Swedish property company, performed well in anticipation of rising indexed linked rates in combination with a rock solid balance sheet.

The weakest contribution came from **Fielmann**, the best-cost eye glasses retailer with strong positions in German-speaking countries in Europe, which traded sideways as sales continue to be subdued. **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. **Amadeus**

FiRe, the leading specialist recruitment business in Germany, was affected by a disorderly return by local authorities to pre-pandemic government training support schemes.

Outlook

While most companies have continued to trade well in the Fund, a handful of businesses have started to report more challenging conditions thanks to wide-ranging pressures on consumer spending, supply chain difficulties and energy-related headwinds.

Nevertheless, we are starting to see attractive opportunities for the fund. While we are broadly happy with the composition of the Fund, the current market sell-off is providing opportunities to introduce new names into the Portfolio and we see opportunities to improve the aggregate quality of the Fund in coming months. In addition, we will add to positions which in some cases have reached valuation levels not seen since 2008/09.

We raise our £-class dividend expectation for 2022 to 6.60p per share (prev: 6.30p). Dividends have been paid as forecast through the course of 2022, but we are able to raise our expectation for this year on account of forex movements (weakening GBP) and slightly lower friction costs (e.g. withholding taxes). As a reminder, the dividend includes roughly 0.40p per share of Special Dividends. Excluding Specials, our forecast now implies a +24% underlying growth in dividend for 2022.
