Montanaro MidCap 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 share class declined by 3.2% Euro terms, 5.7% ahead of the Stoxx Europe Mid 200 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. **Worldline**, Europe's leading payments processor, saw its shares perform well in part thanks to an inflation-proof business model that positions the company well in the current environment. **Ashtead**, the leading provider of equipment rental in the US and the UK, announced solid trading and raised guidance.

The weakest contribution came from **Dechra**, the UK animal health company, which declined following two moderately dilutive acquisitions. **Amundi**, the European asset manager, softened in line with capital markets. **Warehouses De Pauw**, the key

European player in the development of logistics properties, as the valuation of property companies came under pressure.

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. 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, with some quality companies in our universe are trading near lows last seen during the Credit Crunch. 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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