MONTANARO

ASSET MANAGEMENT

Montanaro Better World Fund

Quarterly Commentary – Q4 2022

The Better World Fund is classified as an Article 9 Fund under SFDR

Market review

As the global pandemic of Covid-19 eased, some commentators suggested an economic boom was on the cards. Freed from lockdown, the world was ready to party*:* *"Goodbye virus…hello Roaring Twenties"* screamed one hopeful article in the *Financial Times*. You only had to look back a century to the boom that followed the 1918 pandemic (Spanish Flu) to see what would follow: a hedonistic decade of economic growth and stock market excess spurred by technological innovation (the car and the radio); *"the illicit thrill of Prohibition moonshine and the un-girdling of women"*[1]. London had its *"Bright Young Things",* New York the Jazz Age of *The Great Gatsby*.

While economic growth initially rebounded faster from the impact of Covid than many had expected, 2022 brought surprises that derailed this trajectory. The first war in Europe since the Second World War brought with it rising oil prices and inflation unseen in a generation. The era of easy money came to an abrupt halt. The mood music changed. It was as brutal a start to a year as we can remember.

Our Funds recorded one of the worst months ever in relative terms in January 2022. The reason for this was a dramatic style rotation from Growth to Value, one of the fastest that we have witnessed in over 30 years of managing Small & MidCap portfolios. The swift change in sentiment was due to a burst of global inflation, which stoked fears of interest rate rises and disproportionately hurt long duration assets, notably Growth Small & MidCap equities.

The year did not get much better for Quality Growth managers as recessionary fears mounted. Exacerbated by the dreadful war in Ukraine, investors sought refuge in larger companies. The result was our worst year looking after investments for our clients since 2008 on an absolute basis and our worst relative year since the Eurozone crisis of 2013. Usually, our Portfolios hold up well in market downturns due to their high quality. Not so this time. The rotation out of SmallCap, Quality and Growth was a "perfect storm".

It is never nice to report such disappointing results and for this we are sorry. Yet as we note below, the outlook offers us hope for the months ahead.

[1] "The need for a damned good party", *Financial Times*, 1 January 2021

Portfolio

During the quarter, the NAV of the sterling share class declined by 1.5%, an underperformance of 4.7%. After four strong years of performance, 2022 was an extremely tough period for the Fund: the NAV declined by 30%, an underperformance of some 20%. As the Fund approaches its 5-year anniversary, it remains ahead of benchmark since launch and has delivered a gain of 43% to investors (in GBP).

The strongest contribution during the quarter came from **Chr Hansen**, a supplier of bioscience based natural ingredients helping to improve human health and food production, which popped after Novozymes launched a takeover bid. **Bruker**, a leading global developer of scientific instruments, saw its shares rerate following consensus-beating Q3 results on top and bottom line. **Terna Energy**, a Greek producer of renewable energy, gained after increasing EBITDA guidance for the year.

The weakest contribution came from **Advanced Drainage Systems**, a leading manufacturer of water pipes and water management solutions, which saw its shares derate following a strong historic run. **Zscaler**, the global leader in cloud-based Zero Trust cyber security, also saw its shares derate despite excellent earnings growth, as interest rate hikes affected growth equity valuations. **Entegris**, the advanced materials and filters supplier to the semiconductor industry, weakened as Q3 results were impacted by US semiconductor export controls to China.

Outlook

How to think about the months ahead from an investment perspective? Perhaps like the Aymara Tribe in South America, we should walk backwards into the future. In their culture, the most important feature of time is what we know: *"we can see the present and the past; they are laid out before us…anything we know or believe about the future is based on inference from what we have experienced in the present or the past…when making plans for the future, we should take much the same attitude as if we were walking backwards into unknown terrain"*[2]. As an investment house founded by an anthropologist, we find such a philosophy appealing.

With this in mind, what do we know and how can this inform our thinking? Equity value is more attractive in our Quality Growth segment of the market than it has been for years. This market segment is directly linked to the sustainable investments that we invest in. Delivering impactful products and services, be they new forms of healthcare treatments, manufacturing efficiencies, or renewable energy, are all long-term growth areas of what will become a "new" economy. We believe the trends in

[2] *What We Owe The Future*, William Macaskill

this area are structural and offer support the impact themes we target in the Fund. Many P/E valuations halved in 2022 and are back to 2016 levels or even 2008.

We know that this significant derating was driven by inflation, which dramatically rose last year but appears to have peaked in June. The US consumer price index declined in each of the last sixth months, while European inflation eased more than expected in November. This suggests that monetary policy may be having the desired effect. If this trend continues, central bankers may refrain from further tightening.

We also know that economic growth has slowed, with some regions entering into recession. In such an environment, it is likely that the earnings of equity markets will decline this year. And here comes the nub of our outlook: in such an environment, the well capitalised Quality companies in which we invest should deliver *better* earnings growth than the wider market. As we walk (backwards) into the future, we can have confidence in the resilience of our companies and that, after a very difficult year, they are well placed to deliver attractive returns to our investors over the long term as they have in the past.