MONTANARO
ASSET MANAGEMENT

Montanaro European Focus Fund

(Formerly the Montanaro European MidCap Fund)

Quarterly Commentary – Q3 2023

Market review

The optimism of the summer months was dashed towards the end of the quarter. Rising bond yields were accompanied by similar style headwinds to those of 2022: Growth underperformed Value, while MidCap underperformed LargeCap.

There was a marked difference to 2022, however. Then, equity markets sold-off because interest rates were moving rapidly higher. The decline in markets during the third quarter of 2023 was because investors now expect interest rates to remain *"higher for longer"*.

This was partly explained by surprising economic strength in the US, where the labour market remained extremely resilient. With Halloween fast approaching, the spectre of another interest rate rise spooked both equity and bond markets. The yield on certain benchmark bond indices hit levels last seen during the Global Financial Crisis. It was a painful time all-round for risk assets.

Portfolio

During the quarter, the NAV of the share class declined by 8.2% in Euro terms, an underperformance of 5.7% versus the Stoxx Europe Mid 200 index.

The strongest contribution during the quarter came from **Sage**, the leading provider of accounting software, which traded well following its Q3 trading update which demonstrated strong revenue growth. **Recordati**, the pharmaceutical company, reported solid H1 results and reiterated FY guidance. **Dechra Pharmaceuticals**, the UK animal health company, rose after EQT confirmed its takeover bid for the company.

The weakest contribution came from **MTU**, the aircraft engine manufacturer, which declined on the news that Pratt & Whitney must inspect thousands of engines due to powder metal contamination. **Worldline**, the leading European independent payments processor, saw its shares suffer from negative sentiment towards the payments sector, following disappointing results from a competitor. **Teleperformance**, the leading global Customer Experience management company, continues to selloff on concerns about AI disruption.

Outlook

It is challenging for investors to know where to turn. Cash isn't quite king (that crown is currently shared by the "Magnificent Seven" technology stocks, which have returned 92% on average so far this year), but it offers attractive yields without the risk of market volatility.

Where does this leave our asset class? European SMidCap is lagging LargeCap by more than 5% so far this year. It is on track ofr its third consecutive year of underperformance for the first time in over a quarter of a century.

At some point, this underperformance is likely to reverse. The question is "when?" While market timing is a fool's game, the reasons for owning smaller companies in European is becoming more compelling. Both Small and MidCap stocks trade at low P/Es relative to history, and on large discounts versus LargeCap. In addition, receding inflation is typically supportive of smaller company outperformance.

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