

Montanaro European Smaller Companies 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 by 5%, while SmallCap underperformed LargeCap, the eighth time it has done so in the past ten quarters.

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

The NAV of the share class declined by 7.2% in Euro terms during the quarter, an underperformance of 4.4% versus the MSCI Europe Small Cap benchmark index (in Total Return terms).

The strongest contribution during the quarter came from **VZ Holding**, the Swiss wealth manager, which reported good interim results as interest income was higher than expected. **4imprint**, the supplier of promotional merchandise, rose after raising full-year guidance on the back of strong half-year trading. **Cranswick**, the leading supplier of fresh pork meat products in the UK, traded well after reporting positive volume growth in its Q1 results which led to a more positive full-year outlook from the Board.

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. **Surgical Science**, the leading provider of simulation tools and software for robotic surgery OEMs, reported a deceleration in development revenues, prompting EPS downgrades. **St. James's Place**, the British wealth manager, reported weaker than expected AUM inflows and a fee cut for some of its clients.

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? SmallCap sits on a near record P/E discount versus LargeCap and historically, such multiples have translated into strong relative performance over the following 12 months. The Fund trades on its lowest price-to-book valuation since 2016, despite solid earnings growth forecast for next year of almost 13%. At some point things will turn. Investors should not hold onto their cash for too long.

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