MONTANARO

ASSET MANAGEMENT

Montanaro Global Innovation 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"*, causing the long end of the yield curve to reprice. Q3 was painful period for long duration bonds, and small cap growth equities.

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 Sterling Accumulation B Share Class declined by 12.7%, an underperformance of 12.4% versus the MSCI World SMidCap Index as the Fund was impacted by its focus on high growth technology companies.

The strongest contribution during the quarter came from **Pro Medicus**, the global leader in cloud software for radiology, which posted market-beating growth. The share price has performed well thanks to its attractively resilient end market. **Veeva**, the leading SaaS provider to the biopharma industry, announced strong results and a promising pipeline of recently launched products, which have excited investors. **Boku**, the global leader in direct carrier billing (DCB) payments, saw excellent growth in its new "local payment methods" business.

The weakest contribution came from **Adyen**, the global leader in digital and omnichannel payments processing, which saw a deceleration in its growth caused largely by aggressive pricing tactics used by its North American competitors, causing the market to impair and reprice its long-term growth outlook. **TransMedics**, an innovative provider of organ transplant solutions, saw its shares derate following investor scepticism around its new strategy to build its aviation capabilities, despite posting a strong quarter of earnings. **SolarEdge**, the leading solar PV inverter supplier, weakened after reporting weak demand in Europe.

Outlook

The underperformance of the Fund in Q3 mainly came from a further valuation de-rating, as the long end of the yield curve repriced far more significantly in Q3 than in the whole of H1, with the US 10Y yield beginning the quarter below 4% and exiting the quarter approaching 5%. Such aggressive moves in the risk-free rate in a single quarter are very rare, and our portfolio of growth equities was predictably hit.

Most market commentators do not expect to see any further significant increases in bond yields, while the opposite, a significant drop in bond yields in 2024, is clearly a scenario that some expect. We therefore feel some confidence that the medium-term outlook for the fund is strong.
