MONTANARO
ASSET MANAGEMENT

WS Montanaro Global Select 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

During the quarter, the NAV of the Sterling Accumulation Share Class declined by 6%, an underperformance of 6% versus the MSCI World SMidCap Index.

The strongest contribution came from **Partners Group**, the Swiss private markets asset manager, which reported strong numbers as its performance fee income remained strong. **VZ Holding**, the Swiss wealth manager, reported good interim results as interest income was higher than expected. **Houlihan Lokey**, the US corporate financial advisor, did well as the US economy remained resilient.

The weakest contribution came from **Mensch und Maschine**, the German provider of CAD/CAM, PDM and BIM software, which drifted as investors grew concerned about the outlook for the German industrial economy. **Paycom**, the leading provider of payroll software, posted slightly soft results. **MTU**, the aircraft engine manufacturer, declined on the news that Pratt & Whitney must inspect thousands of engines due to powder metal contamination.

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 short term savings offer attractive nominal yields without the risk of market volatility.

Where does this leave our asset class? Global SMidCap has underperformed LargeCap in 8 of the past 10 quarters. The last time there was such a stretch of underperformance was in the early 1990s. A result is that the asset class now trades well below its historical average P/E, on 16.6x, two standard deviations below its long-term average versus LargeCap. Cooling inflation should be supportive for smaller companies, particularly the growth businesses that we seek to invest in. At some point things will turn. Investors should not hold onto their cash for too long.

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