MONTANARO
ASSET MANAGEMENT

# Montanaro European Focus Fund

*(Formerly the Montanaro European MidCap Fund)*

Quarterly Commentary – Q1 2024

## Market review

Equity markets continued to be dominated by the Magnificent Seven in the first quarter of the year, a sobriquet that could one day be viewed in ironic terms. The 10 largest stocks in the MSCI All Country World Index accounted for 19.5% of the widely followed benchmark of 23 developed and 24 emerging countries, as of April 2024. This was just 9% as recently as 2016. This poses real risks for the swathes of assets invested passively.

Market concentration is also a risk in European Markets, where a slightly less catchy term has taken hold: the “GRANNNOLAS’S”*, coined to refer to 11 of Europe’s biggest stocks, account for half of the STOXX 600 gains over the past year.

Nevertheless, the market dominance of these large companies meant that SmallCap continued to underperform LargeCap, while SmallCap Growth lagged Value as economic data surprised on the upside.

Despite these dynamics, it began to feel like a stock picker’s market once again during the quarter. Our companies enjoyed generally positive earnings updates, proof that operationally they are performing well.

## Portfolio

During the quarter, the NAV of the share class increased by 3.8% in Euro terms, an outperformance of 0.9% versus the Stoxx Europe Mid 200 index.

**The strongest contribution** during the quarter came from **Moncler**, the Italian luxury outerwear brand, which reported solid results particularly in its direct-to-consumer channels and smaller product categories such as knitwear and footwear. **MTU Aero Engines**, the aircraft engine component maker, advanced on positive news that the GTF engine inspection programme remains on track, following the powder metal contamination issue. **BioGaia**, the supplier of probiotics, benefitted after reinstating the full dividend payout policy.

**The weakest contribution** came from **Edenred**, the leading issuer of digital vouchers, which declined on the news that the Italian tax authorities had launched an investigation into potential bid-rigging. **Teleperformance**, the global provider of outsourced customer experience management, declined sharply on the news that Klarna had deployed a fully AI-trained customer service bot. **Warehouses De Pauw**, the key European player in the development of logistics properties, underperformed in the first quarter alongside most of the property sector on the back of negative sentiment from the high interest rate environment.

**Outlook**

Equity investors continue to be faced with something of a conundrum: how to achieve diversification in portfolios at a time when performance is dominated by such a narrow band of stocks?

We continue to believe that the smaller companies space looks more attractive than it has for some time, relative to recent history. After a generally good earnings season, valuations are compelling, particularly when compared to LargeCap. European MidCap is trading on an 6% discount to LargeCap, higher even than during the Global Financial Crisis of 2008.

In addition, while the market undoubtedly got ahead of itself in its anticipation of interest rate cuts, inflationary pressures continue to be easing, benefitting two things: the supply chain issues that some of our companies have been exposed to and destocking, which was particularly troublesome for certain Healthcare stocks. As we look ahead towards the rest of the year, we hope that the performance of our stocks can outshine macroeconomic headlines.

* *The eleven GRANNNOLAS'S stocks are: Nestle (NESN.ZU), Roche (ROG.ZU), Novartis (NVS), GlaxoSmithKline (GSK.L), AstraZeneca (AZN.L), LVMH (MC.PA), L'Oreal (OR.PA), Novo-Nordisk (NVO), SAP (SAP), and ASML (ASML).*

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