MONTANARO
ASSET MANAGEMENT

Montanaro European Smaller Companies 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

The NAV of the share class rose by 4.8% in Euro terms during the quarter, an outperformance of 3% versus the MSCI Europe Small Cap benchmark index (in Total Return terms).

The strongest contribution during the quarter came from **4imprint**, the provider of promotional products, which rose after full-year profits beat expectations and cash flow was strong, driven by improved working capital. **CTS Eventim**, the European provider of ticketing services, gained after full-year results beat expectations and the concert pipeline continued to be strong. **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.

The weakest contribution came from **Melexis**, the Belgium supplier of semiconductor chips/sensors for the automotive industry, which underperformed as the industry continued its destocking process. **Kainos**, the provider of digital transformation services primarily to the UK Government, weakened during the quarter alongside the wider IT services sector. **Carel**, the Italian HVAC/R programmable controller manufacturer, traded lower after signalling a weak outlook, albeit with a gradual recovery anticipated throughout the year driven by heat pumps and refrigeration markets.

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 SmallCap 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 SmallCap is trading on an 11% 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).*