MONTANARO

ASSET MANAGEMENT

Montanaro Global Innovation 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.

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.

Stronger than expected US economic and inflation data led investors to temper expectations for rate cuts by the Federal Reserve, placing pressure on stocks with longer duration cash flows that typify this portfolio.

Portfolio

During the quarter, the NAV of the Sterling Accumulation B Share Class increased by 1.9%, an underperformance of 4.6% versus the MSCI World SMidCap Index.

The strongest contribution during the quarter came from **Adyen**, the global leader in digital payments processing, which continued to rerate following excellent above-consensus results for 2023. **Bruker**, the global manufacturer of high-IP scientific research instruments, posted the best Q4 results amongst a crowded peer group and was rewarded with a strong rerating throughout Q1. **Veeva**, the largest SaaS software vendor into the Life Sciences/Pharma industry, delivered strong Q4 results and enjoyed positive sentiment around its new CRM architecture.

The weakest contribution came from **SiTime**, the provider of silicon-based timing solutions, which declined after reporting continued weak demand and inventory destocking among its customers, resulting in weaker than expected guidance. **Bytes**, the leading UK re-seller of enterprise software, suffered from the surprise resignation of its CEO, who was well-regarded. **KeePer Technical**, the Japanese automotive coating company, reported lower sales in February due to unseasonably wet weather and weak domestic vehicle sales due to OEM issues at Toyota, Honda and Subaru.

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. The MSCI World SmallCap index is trading on an 11% discount to LargeCap, higher than even 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.