MONTANARO
ASSET MANAGEMENT

Montanaro UK Income Fund

Quarterly Commentary – Q1 2024

Market review

Global equity markets continued to be highly concentrated in Q1, with performance dominated by the Magnificent Seven. Recent divergence in performance even within this group, however, illustrates that the status quo cannot be taken for granted; markets are forever in flux. The group's sobriquet may 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 concentration poses real risks for the swathes of assets invested passively.

For the time-being, however, this dominance was one of the reasons why UK equites remained an ugly duckling on the world stage.

Within the UK, SmallCap remains particularly unloved. This was not helped by expectations for interest rate cuts, which were tempered during Q1 as economic data showed resilience and inflation continues to be sticky. SmallCaps are, in general, longer-duration assets than LargeCaps and therefore came under pressure, underperforming LargeCap in the UK by 4% in Q1. Furthermore, the Growth & Quality style factors, to which the Fund is also aligned, both lagged by 1%. These three main style exposures of the Fund – SmallCap, Growth and Quality – have now underperformed by 49%, 18% and 15% respectively over the last three years.

Portfolio

During the quarter, the NAV of the Sterling seed share class rose by 1.9%, an underperformance of 1% versus the benchmark index.

The strongest contribution came from **4imprint**, the provider of promotional products, which rose after full-year profits beat expectations and as it issued a robust outlook with the expectation of further market share gains. **Vistry**, the housebuilder and leader in partnership housing, performed well after reporting strong full year numbers and announcing significant progress in their strategy of transitioning to a capital light model. **Clarksons**, the shipping brokerage firm, outperformed after reporting another exceptional year despite the headwind of lower freight rates.

The weakest contribution came from **Big Yellow Group**, the market leader in the self-storage sector, which underperformed alongside most of the property sector on the back of negative sentiment from the high interest rate environment. **Kainos**, the provider of digital transformation services primarily to the UK Government, weakened during the quarter as investors grew cautious around the impact of the upcoming UK election. **FDM Group**, the provider of training-placement IT services, announced weak results as demand for IT skills within Financial Services declined.

Outlook

We believe that SmallCap looks more attractive than it has for some time. Valuations are compelling (particularly when compared to LargeCap), exacerbated by outflows which over the last two years have exceeded those of the Global Financial Crisis. The UK remains unloved on a global basis, despite the fact that it is home to some fantastic, world leading companies managed by outstanding management teams.

After a period dominated by macroeconomics, it has begun to feel like a stock picker's market once again. Our companies have enjoyed generally positive earnings updates, indicating that operationally they are performing well.
