MONTANARO
ASSET MANAGEMENT

MESCT

Montanaro European Smaller Companies Investment Trust

Investment Commentary
Quarterly review - Q1 2025

Q1 Returns – Europe xUK outperforms the US but SmallCap continues to lag:

- Europe outperforms the US by 14% in Q1 – one of the best quarters relative this century
- European returns driven by Spain (+18%), Italy (+13%) and Germany (DAX +12%)
- European Small xUK underperformed LargeCap by 2% (MSCI Europe Small Cap xUK Index: +5%)

Valuation:

- European SmallCap xUK on largest P/E discount v. LargeCap (12%) in 20+ years

All figures in GBP.

The first quarter of 2025 proved volatile for global equity markets, marked by a significant shift in sentiment away from the United States towards Europe. What began as a consensus trade to "*overweight the US*" rapidly unravelled, culminating in the largest underperformance of US equities relative to the rest of the world in over two decades. The MSCI Europe Index, by contrast, posted its strongest start to the year since the mid-1980s, buoyed by falling interest rates, attractive valuations and a historic €500 billion fiscal package announced by Germany's new government. With the debt brake loosened to enable near-unlimited defence and infrastructure spending, investors responded to a seismic shift in European fiscal policy.

The initial rotation into European equities saw capital flow into specific themes – namely aerospace & defence, infrastructure and materials – areas we are typically underweight given our quality-focused approach. The European SmallCap ex-UK index was led by these sectors, reflecting a market environment less favourable to our positioning.

Portfolio

During the quarter, the NAV of the Montanaro European Smaller Companies Trust ("MESCT") gained by 1.9% in GBP, an underperformance of over 3.1% relative to the MSCI Europe SmallCap (ex UK) Index. For the financial year ended 31 March 2025, the NAV fell by 1.7%, versus the benchmark return of -1.1%.

The **strongest contributors** during the quarter were:

- **Kitron** – the Norwegian electronics manufacturing services provider performed strongly in Q1 2025, supported by robust order momentum and recent contract wins in the Defence and Aerospace sectors. This boosted investor confidence and prompted analysts to upgrade their EPS growth estimates.

- **Plejd** – the Swedish developer of smart lighting and home automation solutions rose after reporting very strong Q4 2024 revenue growth of +27% year-on-year, driven by strong demand across all product categories and regions. Installations grew +36% YoY, a leading indicator pointing to further acceleration in revenue.

- **Invisio** – the Swedish developer of communication systems for defence and security rose on the back of strong order books, driven by incremental European defence procurement.

The **weakest contributors** during the quarter were:

- **NCAB** – the Swedish supplier of printed circuit boards weakened as it continued to face a downturn, with seven consecutive quarters of revenue declines. The weakness has been driven by soft European demand, inventory destocking, and subdued industrial activity. Profitability was further impacted by negative operating leverage, IT and M&A integration costs, and restructuring expenses.

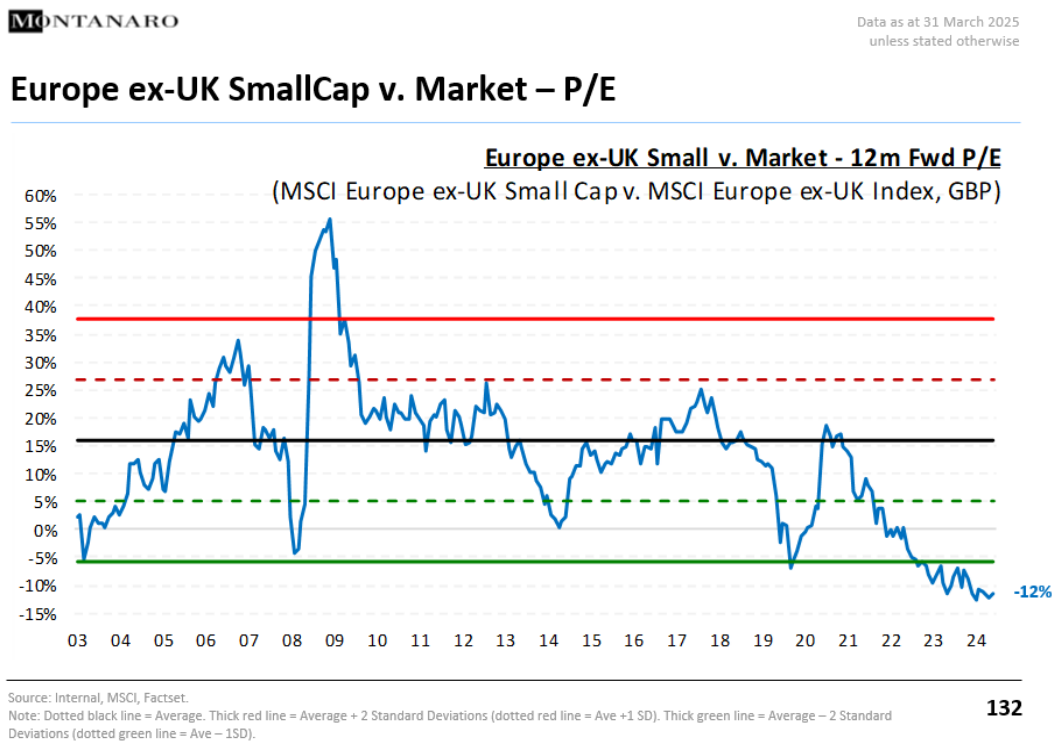
- **IMCD** – the global distributor of specialist chemicals weakened on concerns that recovery momentum may stall amid a potential US slowdown.

- **Biotage** – the Swedish provider of solutions for drug discovery and development reported weaker-than-expected growth.

Outlook

After an extended period of underperformance and valuation compression, there are tentative signs that European SmallCap may be approaching a turning point. A powerful combination of falling borrowing costs, improving economic momentum and a historic shift in European fiscal policy – most notably in Germany – has rekindled optimism that SmallCaps could be set for a broader re-rating. SmallCaps remain more exposed to domestic economic cycles than their LargeCap peers, so the potential move into an "early cycle" environment – driven by stimulus and lower rates – could prove supportive.

Valuations continue to be a major attraction. European SmallCaps are currently trading at one of the largest discounts to LargeCaps in history, despite typically commanding a premium. For patient investors, this dislocation offers attractive risk-reward potential, especially as inflation eases and rate cuts edge closer.



Adding complexity is the escalating risk of a global trade war, potentially echoing the turbulence of the 1930s. President Trump's proposed tariffs are likely to trigger economic downgrades – though revisions and forecasts will be clouded by considerable uncertainty. History suggests that investors often react strongly to such headlines, making bold allocation decisions that are difficult to time and frequently misjudged. Rather than attempting to second-guess shifting policy dynamics, we are staying close to our companies, focusing on fundamentals and asking what they are seeing on the ground. European SmallCaps tend to offer more diversified exposure to local economies and can be less influenced by macroeconomic turbulence or the fortunes of a handful of global tech names.

Our emphasis on Quality remains a key strength in this uncertain environment. Well-managed, resilient businesses are often better placed to navigate volatility and deliver consistent returns over time. It is telling that areas of the market that performed well in Q1 – such as domestic banks – have had a poor start to April. This reinforces our view that discipline and a long-term perspective will prove more rewarding than chasing short-term trends.

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