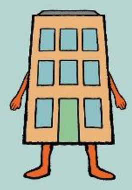
MONTANARO
ASSET MANAGEMENT

European Income Fund



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.

Despite this backdrop, it was satisfying to see the Fund withstand predictable headwinds from US tariff volatility and lingering downturns in industrial capital spending in what was a macro-driven quarter, with good stock-specific performances from, among others, Euronext, Loomis and VZ Holdings.

Arguably the most pleasing aspect of the Fund during the quarter was the resilience of proposed dividends. Having initially expected reductions from companies which had seen earnings pressure, especially in H2 2024, we saw a significant number of businesses propose better-than-expected distributions. We also received a large special dividend from Technogym.

Portfolio

During the quarter, the NAV of the Sterling Share class increased by 4.9%, in line with the benchmark index (in total return terms).

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

- **Loomis** – the Swedish provider of cash handling and secure logistics services rose following a strong Q4 report, which showed healthy growth and expanding margins.
- **Euronext** – the leading European exchange continues to deliver consistent growth beyond its core cash equities and trading volumes.
- **Kitron** – the Norwegian electronics manufacturing services provider performed strongly in Q1 2025, driven by robust order momentum and several recent contract wins in the Defence and Aerospace sectors. This boosted investor confidence and led analysts to upgrade their EPS growth forecasts.

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

- **ENAV** – the Italian provider of air navigation services underperformed after the CFO presented the new regulatory framework (RP4: 2025–2029), indicating that EBITDA for FY 2025 and 2026 will be lower than FY 2023 and 2024 (~€310m) due to regulatory resets.
- **DiscoverIE** – the designer and manufacturer of customised electronics for industrial

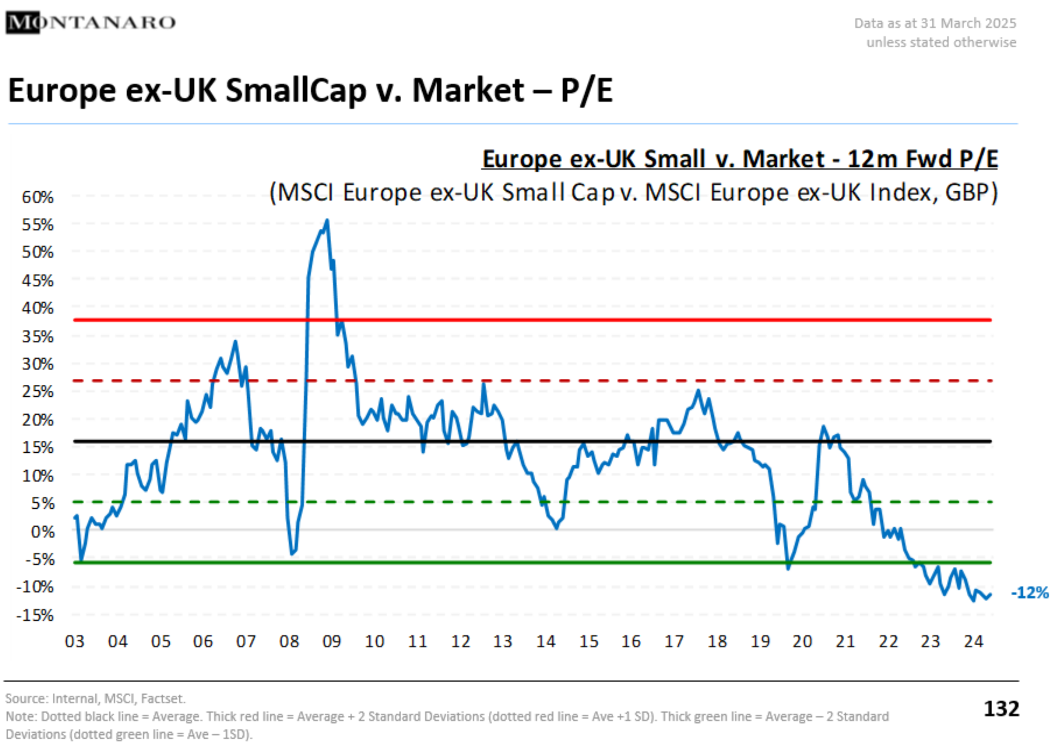
applications saw its shares give up recent momentum as customer confidence remained low, particularly in Europe. The business, which is geared into customer capex cycles, continued to face headwinds from ongoing de-stocking. US tariff news added pressure, though direct exposure appears limited.

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

Outlook

After an extended period of underperformance and valuation compression, there are tentative signs that European SmallCaps 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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April 2025

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