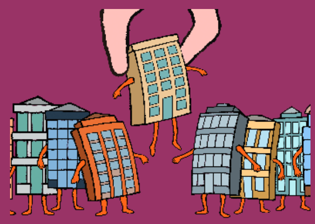
MONTANARO
ASSET MANAGEMENT

European Smaller Companies Fund



Investment Commentary
Quarterly review - Q1 2025

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

- Europe outperforms the US by 14% in Q1 - best quarter relative this century
- European returns driven by Spain (+17%), Italy (+12%) and Germany (DAX +11%)
- European Small underperformed LargeCap by 5% (MSCI Europe Small Cap Index: +1%)

Earnings / Valuations:

- European SmallCap on largest P/E discount v. LargeCap (11%) in 20+ years

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.

Against this backdrop, the Montanaro European Smaller Companies Fund (MESCF) had a variable first quarter. The Fund began the year positively in January, but performance was hindered as macroeconomic uncertainty and the intensity of the year-end reporting season took hold. 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. In a quarter where the MSCI Europe Small Cap Index was only marginally positive, Construction Materials rose +12%; Metals & Mining +31%; Banks +17%; Insurance +12%; and Defence +33%. The Fund's modest exposure to these areas created a meaningful style headwind during the quarter.

While we continue to assess candidate stocks in a number of sectors, we remain disciplined and long-term in our approach: rather than chasing momentum, we are focused on identifying truly exceptional businesses at sensible valuations – companies that can grow sustainably through the cycle.

Performance & Portfolio

During the quarter, the NAV of the Euro distribution share class declined by 4.8%, an underperformance of 5.7% versus the MSCI Europe Small Cap benchmark index (in total return terms).

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

- **Plejd** – the Swedish developer of smart lighting and home automation solutions performed well after reporting very strong Q4 2024 revenue growth of +27% year-on-year, reflecting strong demand across all product categories and regions. Installations grew +36% YoY, which is a leading indicator suggesting that revenue growth is likely to accelerate.

- **Fortnox** – the Swedish provider of cloud-based financial administration software for SMEs soared after receiving a joint cash offer from First Kraft and private equity group EQT at a 38% premium to the previous closing share price.

- **VZ Holding** – the Swiss financial services provider specialising in pension and investment advice performed well on strong results and continued growth in its consultant business.

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

- **4imprint** – the supplier of promotional merchandise fell as the threat of Trump tariffs hurt sentiment among US small businesses.

- **Biotage** – the Swedish provider of solutions for drug discovery and development reported weaker-than-expected growth.
- **IMCD** – the leading global distributor of specialist chemicals, weakened on concerns that recovery momentum may stall amid a potential US slowdown.

Engagement / ESG

We engaged with **Games Workshop** to discuss the remuneration policy, with a focus on ensuring alignment with the company's distinctive culture while enhancing its ability to attract and retain senior talent. A key topic was the proposed Triennial Share Awards scheme, designed as an alternative to a conventional LTIP. This reflected internal reluctance towards LTIPs following prior implementation challenges. We have since reviewed the consultation outcome and are supportive of the updated policy ahead of the upcoming AGM.

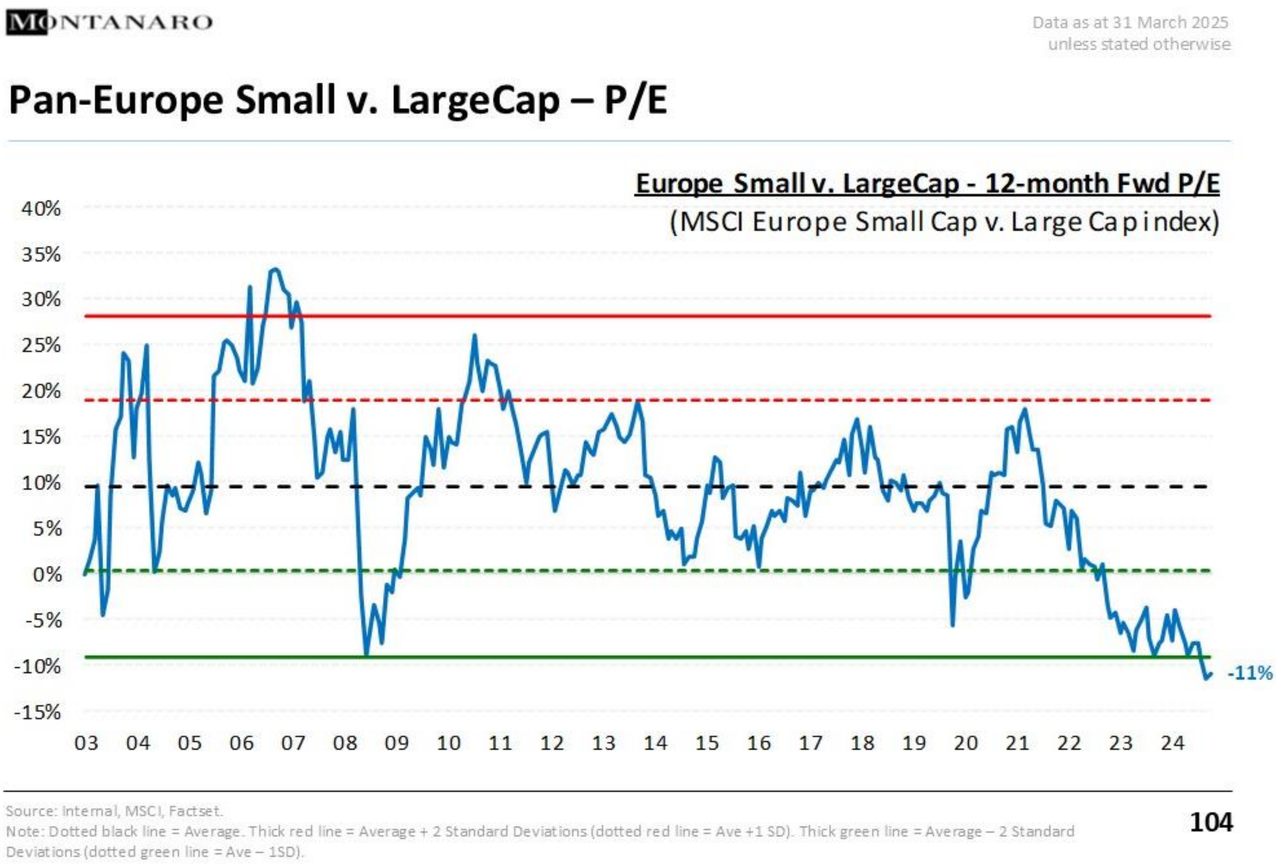
We also discussed the proposed changes to **Merlin Properties'** remuneration policy. The company outlined a new LTIP structure with performance metrics comprising Absolute TSR (35%), Relative TSR (35%), Sustainability Progress (15%), and Dividend per Share Growth (15%). We recommended extending participation to executive directors and senior management, alongside the inclusion of robust malus and clawback provisions. Merlin acknowledged the feedback as constructive. We will assess the revised LTIP proposal as part of the AGM materials.

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. In Germany, the loosening of fiscal rules and a €500 billion investment package focused on defence and infrastructure has already contributed to a pick-up in mid-cap performance. Meanwhile, gains in the Euro and early signs of positive economic surprises across the region suggest sentiment towards Europe may be turning, encouraging a rotation from global equities back into more locally focused companies.

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.

While market timing remains difficult, we believe the medium-term outlook for MESCF is increasingly constructive. The Fund continues to focus on high-quality, growing businesses aligned to long-term structural themes. If the macroeconomic picture improves as anticipated, the portfolio is well positioned to benefit from a re-rating of undervalued, well-run SmallCap companies across the region.

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April 2025

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