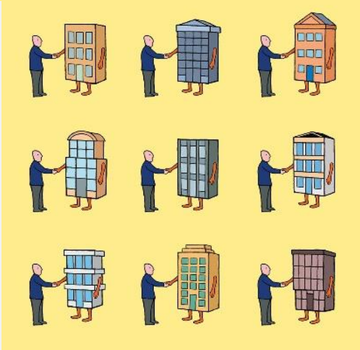
MONTANARO

ASSET MANAGEMENT

UK Income Fund



Investment Commentary

Quarterly review - Q1 2025

Q1 Returns – UK outperforms Global equities but Small lagged LargeCap significantly:

- FTSE All-Share +4.5%: 12% outperformance v. S&P 500 is largest in c.30 years
- MSCI UK SmallCap Index: -3.6%
- MSCI UK SmallCap versus MSCI UK Large: -11.5%
- Numis Small lagged Numis Large by 12.5%: Worst quarter v. Large since 4Q08 (2nd worst since 1992)

Valuation:

- UK Small on a 13% P/E discount v. LargeCap – highest in 5 years *

** * Based on Numis Smaller Companies ex-IC Index v. MSCI UK Large Cap Index. The MSCI UK Large Cap index is used in the absence of P/E metrics for the Numis Large Cap Index. The sector returns are based on the Numis Smaller Companies (ex-IC) Index.*

Q1 2025 was a tough quarter for the Montanaro UK Income Fund ("UKIF" or the "Fund"), which once again faced headwinds from its investment style (SmallCap, Quality, Growth) relative to its official benchmark, the IA All Companies Sector. UK SmallCap significantly underperformed LargeCap by over 11%, Growth stocks lagged Value, and Quality stocks were almost 4% behind the broader market.

During the previous quarter, we identified four key areas that negatively impacted performance: (1) UK domestic cyclicals affected by consumer confidence (e.g., housing, retail); (2) REITs impacted by spiking bond yields; (3) staffing companies facing a severe ongoing cyclical downturn; and (4) IT Services companies linked to UK Government spending.

In Q1 2025, headwinds (2) and (4) abated. REIT valuations stabilised as the UK 10-year bond yield showed limited movement. Tritax BigBox was the strongest performer amongst our holdings, as it announced its first data centre development project. IT Services companies Computacenter and Bytes Technology provided reassuring updates; double-digit share price pops were indicative of the significant negativity that is currently baked into market valuations.

Bucket (3), staffing companies, slightly detracted but also showed signs of operational stabilisation, with trading updates from FDM and SThree towards the end of the quarter indicating conditions had not worsened. Just like with Computacenter and Bytes, these updates were greeted with relief rallies. While the staffing cycle shows no obvious sign of material improvement in the near term, it is worth noting that our companies in the sector have strong balance sheets, which gives us confidence in their ability to emerge strongly when conditions improve.

Bucket (1), UK domestic cyclicals, remained challenging, primarily driven by Greggs, whose like-for-like growth slowed notably due to reduced consumer confidence post-Budget. Other notable detractors included B&M European Value Retail and Marshalls. Despite near-term headwinds, attractive valuations and strong fundamentals underpin our positive long-term outlook.

In Q1, a new macro headwind also emerged in the form of uncertainty from Donald Trump's US tariffs, indirectly impacting business confidence globally. Following a trip to the US in early March, we reduced several US-exposed positions.

Relative performance also suffered from the Fund's lack of exposure to the Aerospace & Defence and Metals & Mining sectors, which performed strongly in Q1.

Performance & Portfolio

During the quarter, the NAV of the Sterling seed share class of the Dublin domiciled Fund declined by 7%, compared to a benchmark return (IA All Companies Sector) of 0.2%.

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

- **XPS Pensions** – the pensions consultancy and administration provider rose on the back of a positive profit upgrade, supported by strong demand and disciplined cost management.

- **Games Workshop** – the creator of tabletop miniature games and fantasy products announced an upgrade to profit expectations.
- **Computacenter** – the provider of IT infrastructure and managed services rose following the publication of full-year results with a positive outlook, underpinned by a strong order backlog.

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

- **Greggs** – the bakery chain known for pastries, sandwiches and coffee declined as like-for-like volumes remained negative in the first weeks of 2025.
- **DiscoverIE** – the designer and manufacturer of customised electronics for industrial applications declined amid ongoing customer de-stocking and low confidence, particularly in Europe and the UK. US tariff concerns also added pressure, although direct exposure appears limited.
- **4imprint** – the supplier of promotional merchandise fell as the threat of Trump tariffs weighed on sentiment among US small businesses.

In March, we initiated a new holding in **Baltic Classifieds Group**, a dominant online classifieds business in the Baltic region, following a near-20% share price decline linked to macro concerns over Russia-Ukraine tensions. The company exhibits strong pricing power, high earnings visibility, and significant dividend growth potential. **Britvic** exited the portfolio following its acquisition by Carlsberg.

Engagement & ESG

We engaged with **Games Workshop** regarding their remuneration policy. The discussion focused on aligning remuneration with company culture while improving executive compensation to retain and attract key talent. The proposed Triennial Share Awards scheme was discussed as an alternative to a typical LTIP, given internal resistance to LTIPs stemming from historical experiences. We have since been provided with the results of the consultation and are happy to support the policy at the upcoming AGM.

We provided feedback to the **FRC** regarding proposed changes to the **UK Stewardship Code**. Our response, aligned with the UKSIF and PRI submissions, advocated for retaining references to the economy, environment and society within the stewardship definition. We also supported reducing reporting burdens while maintaining transparency. We await the FRC's response.

Outlook

Overall, while UK SmallCap remains out of favour, we remain confident in the long-term intrinsic value of our Portfolio. The recent announcement by President Trump of sweeping new tariffs - including a 10 per cent levy on UK goods and a more punitive 20 per cent rate on European Union imports - adds fresh complexity to the global trade environment. While the UK has not escaped unscathed, it appears relatively less exposed than its European counterparts.

It is also worth recalling that only c. 20% of the Fund's revenue exposure is to the US, the majority of which is either services or product supplied by local manufacturing. Sharply positive share price reactions to recent satisfactory (but not stellar) updates from our holdings reinforce our conviction in the significant latent value that remains in our Portfolio. Indeed, it is evident that extreme negativity is already priced into UK Small & MidCaps. As such, any further share price declines in UK domestic equities caused by Trump's actions will create even more compelling buying opportunities, in our view.

Finally, it is pleasing to note that dividend trends remain robust. Driven by stronger-than-anticipated ordinary dividends and a special dividend from 4imprint, the Fund's distributions in 2025 will likely be ahead of our previous expectations.

Guido Dacie-Lombardo
April 2025

Montanaro Asset Management Ltd | 53 Threadneedle Street | London EC2R 8AR

T: +44 20 7448 8600 www.montanaro.co.uk