

BETTER WORLD FUND

Investment Commentary

Q2 2024



Market review

The good equity returns were to be found in LargeCap during the opening half of 2024. SmallCap underperformed its larger peer by a staggering 12% over the last 6 months, while MidCap did not fare much better. This marked the worst half-year underperformance for Global SMidCap for over a quarter of a century. Unless this reverses, the asset class will deliver a record 7th consecutive year of underperformance versus LargeCap.

What was behind this dramatic divergence? Conditions in the equity markets continued to be dominated by two main themes: stickier-than-expected inflation and the ongoing domination of the large technology stocks in the US. In both the US and parts of Europe, stubborn services inflation led certain Central Banks to delay interest rate cuts. This had a negative impact on smaller companies which are more interest rate sensitive compared to their larger peers.

LargeCap technology stocks – and in particular anything “A.I.” related – performed strongly. Nvidia, which on its own is worth roughly the same as the entire Russell 2000, continued its heady triple-digit ascent (although the Magnificent Seven did begin to show some signs of bifurcation).

Towards the end of the second quarter, political upheaval weighed on most parts of the equity markets. The UK faced an election and a change of government, while in France a snap election was called by Emmanuel Macron, increasing market volatility. In the US, the election bandwagons began to roll.

For sustainable investors, this environment continued to pose difficulties, seen perhaps in the performance of the MSCI Global Environment (ACWI) index, which was one of the worst performing indices globally in H1 (-14% in GBP). A ray of light, however, came from Fund flow data. According to Calastone, some £5.1 billion of money “returned” to ESG Equity Funds. This, after a dramatic £3.1 billion of net outflows in the middle part of last year. However, it must be noted that much of these flows have gone to passive, rather than active, strategies.

Portfolio

During the quarter, the NAV of the sterling share class declined by 5%, an underperformance of 2% versus the MSCI World SMidCap Index. [For returns in other currencies please see Figure 1 at the end of the commentary].

The strongest contribution during the quarter came from **TransMedics**, the provider of products and services used to transport organs for transplantation surgery, which continued to win customers and grow revenue at an impressive rate. **Nova**, the semiconductor metrology solutions provider, rose on accelerating demand and further evidence of market share gains. **Sdipotech**, the Swedish acquirer of European sustainable infrastructure companies, reported first-quarter results above consensus following a well-received acquisition.

The weakest contribution came from **Sartorius Stedim Biotech**, the provider of equipment used in the production of biologic drugs, which continued to underperform following management caution around order intake. **Alfen**, the smart energy solutions provider, suffered a profits warning following project delays in its Energy Storage segment. **Bruker**, the global specialist vendor of advanced scientific instruments, drifted on continued apathy around both its end market strength and its recent M&A strategy.

Outlook

At the end of 2023 we suggested that the conditions might be ripening for the “SmallCap Effect” to emerge from its multi-year hibernation. This is yet to happen. How does this set us for the next six months?

Despite inflation remaining “higher for longer”, there were clear signs of cooling towards the end of June. On a June annualised basis core CPI in the US was

below 1%, while the three-month average was only a whisker above 2%. Most reassuringly for Growth investors, such as ourselves, CPI shelter inflation (the average cost of housing in the US) plummeted to 2%. Not so long ago it was above 8%. The market reaction to this data? Futures priced in a 91% probability of a rate cut in September (up from 55%); Treasuries rallied and the yield curve steepened; and the technology behemoths fell (Nvidia by almost 6%), while SmallCap gained.

While one month of data is too little to indicate that we are in “risk on” mode to an extent that SMidCap will catch up on this year’s underperformance anytime soon, it is another indicator that market dominance comes hand-in-hand with concentration risk. Some recent research that we found interesting was published by Bridgewater (*The life cycle of market champions*): “a consideration for investors today is that most investors’ portfolios have higher exposure than ever to the current champions [the large tech stocks].. over a third of a typical US-market-weighted portfolio is allocated to the current basket of champions, and in a world portfolio, this share ends up close to 20%—the highest in over 50 years”.

With macro data becoming more supportive of smaller company investing, it is worth ending with a point on valuation. Global SMidCap has never looked as attractive in over 20 years: the asset class is trading on near record P/E and P/Book discounts to LargeCap. On a long-term view, now may be as good a time as any for dipping a toe back into SmallCap waters.

Performance

Absolute Returns (Net TR)	GBP	EUR	AUD	USD	CAD
H1 2024	-2.4%	-0.3%	-1.0%	-3.4%	0.1%
2023	7.2%	9.8%	12.9%	13.2%	10.5%
2022	-29.5%	-33.3%	-32.8%	-37.0%	-32.7%
2021	20.0%	27.9%	25.8%	19.0%	17.9%
2020	35.0%	27.8%	26.9%	39.0%	36.7%
2019	29.8%	37.5%	35.4%	35.1%	28.7%
2018 (April launch)	-3.8%	-6.6%	-5.5%	-11.8%	-6.3%

Note: GBP and EUR returns are based on the Fund's GBP and EUR Distribution classes.

AUD, USD and CAD returns are showed for reference only. They are sourced from Bloomberg, which applies the prevailing daily FX rate to the NAV of the GBP Share Class.

Returns v. Benchmark (TR)	GBP	EUR	AUD
H1 2024	-5.8%	-6.0%	-5.8%
2023	-1.9%	-1.9%	-2.0%
2022	-20.8%	-19.7%	-19.7%
2021	2.2%	2.3%	1.9%
2020	22.8%	21.6%	21.4%
2019	7.9%	8.3%	8.4%
2018 (April launch)	0.2%	0.2%	0.4%

Benchmark: MSCI World SMID Cap Index (Net TR)

Latest reports

- [Deep Dive #11: Project Net Zero Carbon 2023](#)
- [Deep Dive #10: The Built Environment](#)
- [PRI 2023 – Assessment Report](#)
- [Proxy Voting Summary 2023](#)

The views expressed in this article are those of the author at the date of publication and not necessarily those of Montanaro Asset Management Ltd. The information contained in this document is intended for the use of professional and institutional investors only. It is for background purposes only, is not to be relied upon by any recipient, and is subject to material updating, revision and amendment and no representation or warranty, express or implied, is made, and no liability whatsoever is accepted in relation thereto. This memorandum does not constitute investment advice, offer, invitation, solicitation, or recommendation to issue, acquire, sell or arrange any transaction in any securities. References to the outlook for markets are intended simply to help investors with their thinking about markets and the multiple possible outcomes. Investors should always consult their advisers before investing. The information and opinions contained in this article are subject to change without notice.

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

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