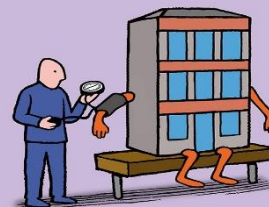


EUROPEAN INCOME FUND

Investment Commentary

Q3 2024



Market review

The “SmallCap Effect¹” showed signs of life in the third quarter of 2024. Europe ex-UK SmallCap outperformed its LargeCap peer by a healthy 1.4%. This marked a second consecutive quarter of outperformance. The last time this occurred was in 2021.

For those of us dedicated to Smaller Companies, it's been a challenging period. However, we see opportunity in this underappreciated sector— less attention heightens the chance of discovering a “hidden gem” and we are keenly searching for them, knowing they hold the potential to become tomorrow's LargeCaps.

The summer months were punctuated by periods of market volatility, particularly in August. This was the result of weaker than expected US economic data, an interest rate hike from the Bank of Japan; and seasonally low liquidity. Market jitters eased in September as the Federal Reserve finally reduced interest rates, while policy makers in Japan also sought to reassure investors. This activity helped propel the Value segment of the equity market, which outperformed Growth over the quarter.

Portfolio

During the quarter, the NAV of the Sterling Share class rose by 1.6%, an outperformance

¹ The “Small Cap Effect” refers to the observed phenomenon in financial markets where stocks of smaller companies (SmallCaps) tend to outperform those of larger companies (LargeCaps) over the long term. This effect was first documented in academic literature by Rolf Banz in 1981. Banz's study found that SmallCaps, on average, had higher risk-adjusted returns than their LargeCap counterparts, which could not be fully explained by traditional asset pricing models like the Capital Asset Pricing Model (CAPM).

of 1.4% versus the composite benchmark.

The strongest contribution during the quarter came from **Loomis**, the provider of cash management services in more than 20 countries, which rose after a strong quarterly report demonstrated a trend of rising margins and growth. **MTU Aero Engines**, a manufacturer of engine components and provider of MRO services, saw its shares rise in anticipation of positive geared-turbo-fan repair activities and excitement ahead of the November Capital Markets Day. **Kaufman & Broad**, the real estate construction and development company, showed good momentum thanks to a more positive macroeconomic environment.

The weakest contribution came from **Atea**, a leading hardware and software reseller in Scandinavia, which reported a disappointing Q2 as spending on networking equipment declined. **Amadeus FiRe**, a specialist employment company, weakened due to subdued labour market activity in Germany. **Kitron**, a Scandinavian electronics manufacturing services provider, lowered its full-year guidance as demand remained weaker than anticipated, with several major customers in the Electrification and Industry sectors continuing to reduce inventories.

Outlook

Despite the good recent performance for the smaller company sector, we remain in a tough period for the asset class. SMidCap have been overshadowed by the dominance of the Large and MegaCaps “GRANOLAS” in recent years and is on track for a fourth consecutive year of underperformance — the first such occurrence this century.

However, the potential for a resurgence is supported by compelling valuations. SMidCap is trading at valuation discount versus LargeCap gap wider than what was observed during the Global Financial Crisis of 2008. The price-to-book discount has reached 38%, hinting at a significant undervaluation. With analysts projecting double-digit earnings growth for the next year, the outlook for SMidCap in 2025 is increasingly optimistic.

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