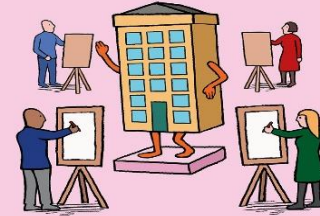


EUROPEAN SMALLER COMPANIES FUND

Investment Commentary

Q3 2024



Market review

The “SmallCap Effect¹” showed signs of life in the third quarter of 2024. European SmallCap outperformed its LargeCap peer by a healthy 2.5%.

This marked only the second quarter of outperformance for Smaller Companies since the final quarter of 2022 (the other being Q4 2023). 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.

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).

Portfolio

The NAV of the Euro distribution share class rose by 7% on a total return basis, an outperformance of 3% versus the MSCI Europe Small Cap benchmark index (in Total Return terms).

The strongest contribution during the quarter came from **Esker**, the French provider of cloud software solutions to make companies' cash conversion cycle more efficient, which rose as it announced a recommended offer from Bridgepoint & General Atlantic. **Belimo**, the global leader in actuators that control air and water flows in buildings to reduce energy consumption and enhance water recycling, saw gains following strong interim results, with data centres highlighted as key growth drivers. **VZ Holding**, the Swiss wealth manager, continued to perform well and reported impressive headline revenue and margin growth figures in its interim results.

The weakest contribution came from **Technoprobe**, the probe card supplier to the semiconductor industry, which saw worse-than-expected margin contraction on the back of a recent acquisition. **4imprint**, the leading provider of promotional products in the US, declined as new customer orders slowed down due to macro-economic uncertainty. **Kainos**, the digital transformation consulting firm, guided to softer revenue on the back of project delays related to the UK election.

Outlook

Despite the good recent performance for the smaller company sector, we remain in a tough period for the asset class. European SmallCap has 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, we may be witnessing the beginning of a shift, with SmallCaps beginning to outperform their larger counterparts. The potential for a resurgence is supported by compelling valuations. SmallCap is trading at an 8% P/E discount relative to LargeCap — a gap wider than what was observed during the Global Financial Crisis of 2008.

Additionally, the price-to-book discount has reached an unprecedented 48%, hinting at a

significant undervaluation. With analysts projecting double-digit earnings growth for the next year, the outlook for European SmallCap in 2025 is increasingly optimistic.

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