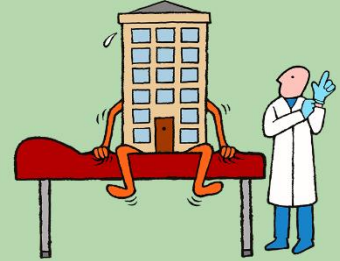


MESCT

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 Montanaro European Smaller Companies Trust (“MESCT”)

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).

increased by 4%, an outperformance of over 3% relative to the MSCI Europe SmallCap (ex UK) Index.

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. **CTS Eventim**, the leading European ticketing services provider for entertainment, rose following the acquisition of See Tickets in the UK and a strong concert line up in Europe. **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.

The weakest contribution came from **NCAB**, the full-service supplier of PCBs, which underperformed after reducing Q3 earnings expectations on the back of continued weakness in European markets (particularly in Germany). **Technoprobe**, the probe card supplier to the semiconductor industry, saw worse-than-expected margin contraction on the back of a recent acquisition. **Kitron**, a leading Scandinavian electronics manufacturing services company, reduced full year guidance as demand remained subdued and several major customers continued destocking.

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 12% 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 51%, 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.

MESCT currently trades at a 12% discount, contrasting sharply with the premium it commanded three years ago, suggesting an attractive entry point for investors. We certainly think so: Montanaro reinforced its confidence in MESCT by acquiring 500,000 shares in July 2024, increasing its stake to ~5%.

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

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