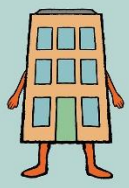
MONTANARO

ASSET MANAGEMENT

European Income Fund

Quarterly review – Q3 2026



Key points:

- Rising bond yields defined the quarter. The ECB raised rates again in September and the strain showed first in French and Italian government bonds.
- Higher yields weighed on rate-sensitive holdings in property and utilities, while an AI-linked sell-off in semiconductor and electrification names hurt our industrial exposure.
- Companies that reported strong results were rewarded. Mips, Loomis and Euronext were the largest contributors.
- We replaced four holdings with businesses offering attractive running yields and growth. Three of the four yield more than 5%.
- We remain confident that the Fund can sustain underlying dividend growth of around 5% a year.

Rising bond yields set the tone for the third quarter. The European Central Bank raised interest rates for the second time this year in September, while higher energy prices pushed Eurozone inflation to 3.3% in August. Continued disruption in the Middle East saw oil prices rise above $100 a barrel, adding to concerns about inflation and the outlook for interest rates. The pressure was particularly evident in France and Italy, where government bond yields rose sharply. Against this unsettled macroeconomic backdrop, European equities weakened in September, although SmallCap outperformed LargeCap over the quarter as a whole. Within SmallCap, Value continued to outperform Growth.

The European Income strategy declined in absolute terms during the quarter but outperformed its benchmark. Rising bond yields weighed on some of the fund's higher-yielding equities, particularly businesses whose models or valuations are sensitive to government borrowing costs. This affected **Kaufman & Broad** (French housebuilder) and **Terna** (Italian electric utility) in particular, while **Merlin Properties** (Spanish REIT) came under pressure amid concerns about potential data centre funding risk. Industrial holdings exposed to semiconductors and electrification were also affected by the broader sell-off in AI-related businesses. Nevertheless, stock selection provided some support, with **Mips**, **Loomis** and **Euronext** performing well following encouraging results. The fund retains its emphasis on high-quality, relatively defensive businesses with attractive dividend yields and opportunities for long-term earnings growth.

We continued to recycle capital into higher-yielding businesses with attractive growth prospects, introducing four new holdings during the quarter. This included **Jumbo**, a leading discount retailer operating across Greece, Romania and Bulgaria, with strong margins, conservative management and an attractive dividend yield; **MAIRE**, an Italian engineering group specialising in gas processing and chemical technologies focused on low carbon chemical tech; and **Van Lanschot Kempen**, a Benelux wealth management and fiduciary services business, benefiting from AuM growth and higher net interest income. All four companies offer attractive growth prospects, while three have dividend yields above 5%.

Elsewhere, we exited **AAK**, **Brenntag** and **Burckhardt Compression**. At AAK, weaker market volumes, increasing competitive pressure and disappointing operational progress had reduced our conviction in the earnings outlook. Brenntag continued to struggle with operational execution, while Burckhardt Compression's exposure to Chinese chemical capacity raised concerns about the longer-term outlook for demand. We also exited **Recordati** following its acquisition.

Towards the end of the quarter, we reduced our positions in **Mensch und Maschine**, **Tryg** and **WDP**. At Mensch und Maschine, a weaker software renewal cycle has weighed on earnings expectations, while Tryg faces pressure from rising yields and increasing resistance to premium increases. WDP has continued to struggle in a higher interest-rate environment, with limited share price progress.

Performance & Portfolio

During the quarter, the NAV of the Sterling Share class decreased by 1.5%, an outperformance of 0.2% relative to the IA Europe ex UK benchmark index (in total return terms).

The strongest contributors during the quarter were:

- **Mips** – the Swedish developer of helmet safety technology advanced as second-quarter results showed organic growth accelerating and strong operating leverage.
- **Loomis** – the Swedish provider of cash handling and secure logistics services climbed after record second-quarter profitability on 24 July, with an EBITA margin of 14.0%, organic growth of 6.7% and bolt-on acquisitions in Argentina and Peru.
- **Euronext** – the European stock exchange operator traded higher after record second-quarter results on 30 July, with revenue up 16.9% and adjusted EPS up 19.8%.

The weakest contributors during the quarter were:

- **Merlin Properties** – the Spanish property owner expanding into data centres softened after Jefferies and Kepler Cheuvreux cut their ratings to Hold in August over data centre tenant credit risk, followed by a draft Spanish data centre decree stipulating renewables integration into the power mix.
- **Kaufman & Broad** – the French residential developer slipped as renewed interest rate tension weighed on French housebuilders and the new-build market declined by more than 23%.
- **Pfisterer** – the German manufacturer of high-voltage cable accessories and overhead line components declined after first-half results showed order intake down 9.4% to €262m despite revenue up 20%, and the shares de-rated further in a wider electrification sell-off.

Geography & sector

Sweden contributed most to the quarter, led by Mips, while Germany was the largest detractor, with Pfisterer the weakest holding. Central banks added to the backdrop. The ECB raised rates again on 10 September and German inflation forecasts moved higher, while the Riksbank held

rates but flagged a weaker krona as an inflation risk and signalled that rises are possible. By sector, Financials contributed most and Industrials cost the most, as electrification and data centre exposed names de-rated in a wider AI sell-off.

Engagement and ESG

BioGaia (**the Swedish probiotics company**)

We engaged with BioGaia to understand its exposure to physical climate risks across its operations and supply chain, including climate-sensitive raw materials and sourcing regions, and the measures in place to manage weather-related disruption. The company confirmed that climate and environmental risks form part of its supplier due diligence, through Sedex assessments, EcoVadis ratings and third-party audits. It has identified palm oil as the ingredient with the highest combined environmental and social impact and is phasing it out of its probiotic products by 2027 where regulatory conditions allow. Supply resilience rests on inventory planning, long-term supplier relationships and approved alternative suppliers. The engagement is now closed. We will continue to monitor how BioGaia develops its climate-risk assessment, including greater consideration of shorter-term climate variability and scenario analysis.

Kri Kri Milk Industries (**the Greek dairy company**)

During the quarter we engaged with Kri Kri to understand the animal-welfare standards applied across its milk supply chain, including how standards are set and monitored, the extent of independent verification and its approach to supplier breaches. Greek and EU regulation provides the baseline, supplemented by the company's own farm control programme and supplier requirements. Kri Kri has introduced independent third-party certification of its Animal Welfare Management System and intends to develop a more quantitative framework built on farm-level welfare indicators. It has also terminated a supplier relationship following a serious breach of its ethical standards. The engagement is now closed. We will monitor implementation of the quantitative framework, including corrective-action processes and independent assurance.

Outlook

The outlook for European equities remains uncertain, with rising bond yields and continued inflationary pressures weighing on valuations, particularly among higher-yielding companies. In this environment, we believe it is increasingly important to distinguish between businesses offering attractive yields supported by sustainable earnings growth and those whose valuations are more sensitive to movements in interest rates. We continue to favour high-quality, cash-generative companies with the ability to grow their earnings and dividends over the longer term.

This approach is reflected in our recent portfolio activity. Since the quarter end, we have reduced our position in **Terna**, where the valuation is sensitive to bond yields and rising interest rates will take time to recoup, as well as **Kaufman & Broad** amidst concerns that persistently high bond yield could slow French housebuilding further into 2027.

The Portfolio has also been affected by takeover activity, with **Recordati** and **Elmera** among the Fund's largest contributors to dividend income. Their disposals will require us to replace this income, and recent portfolio changes have been made with this in mind. We remain focused on maintaining an attractive and sustainable yield without compromising on business quality and continue to believe that the Portfolio can deliver underlying dividend growth of approximately 5% per annum over the longer term.

Despite the uncertain macroeconomic backdrop, we remain positive about the outlook for European SmallCap. Valuations remain attractive relative to LargeCap, while the prolonged period of underperformance among higher-quality businesses has created opportunities for active investors. We believe that a diversified portfolio of well-run, cash-generative companies offering sustainable and growing dividends remains an attractive proposition for investors seeking both income and long-term capital appreciation.

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