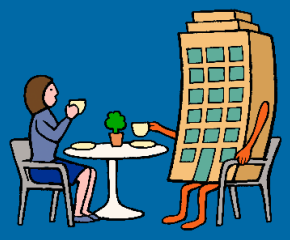
MONTANARO

ASSET MANAGEMENT

MUSCIT

Montanaro UK Smaller Companies Investment Trust

Quarterly review – Q3 2026



Rising bond yields set the tone for the third quarter, as persistent inflationary pressures and geopolitical tensions continued to unsettle markets. The Federal Reserve, European Central Bank and Bank of Japan all raised interest rates in September, while renewed disruption to shipping around the Strait of Hormuz pushed oil prices above $100 a barrel. In the UK, the Bank of England held rates unchanged, although three members voted for an increase, while the 10-year gilt yield reached its highest level since 2007.

Despite this challenging backdrop, UK SmallCap equities performed strongly. The FTSE 250 returned 7.4% over the quarter, while the MSCI UK SmallCap Growth Index gained 5.6%. However, rising bond yields continued to weigh on the valuations of higher-quality growth companies, which remained out of favour.

Company-specific developments were an important driver of returns during the quarter, with earnings announcements prompting significant movements in individual share prices. Continued takeover activity also highlighted the attractive valuations of many UK businesses, with international and private equity buyers increasingly recognising opportunities that appear to be overlooked by public markets.

With the market continuing to favour cheaper, more cyclical businesses over quality growth companies, stock selection remained particularly important. This is consistent with our investment approach. We construct the Portfolio from the bottom up, with the majority of risk attributable to individual stock selection rather than broader market or style factors.

Performance & Portfolio

During the quarter, MUSCIT's NAV rose by 8.0%, compared to a benchmark return of 9.1% (the benchmark including AIM rose by 7.9%), an underperformance of 1.1%. This follows a strong performance in 2026 with the NAV increasing by 16% and outperforming the benchmark by 5%.

The strongest contributors during the quarter were:

- **Kainos** – the provider of IT services specialising in digital transformation, rose on an unscheduled trading update that highlighted strong performance across all divisions and record backlog levels, resulting in upgraded profit expectations.
- **Gamma Communications** – the provider of unified communication and cloud services advanced as Epiris agreed a recommended cash offer of 1,120p per share, valuing the company at about £1.0bn.
- **M.P. Evans** – the producer of palm oil from its plantations in Indonesia climbed as record first-half results showed profit up 21% to $61m and palm oil production up 11%, with the interim dividend raised 39% to 25p.

The weakest contributors during the quarter were:

- **Cerillion –** the provider of billing, charging and CRM software for telecommunications operators slipped on a delay in booking orders.
- **Games Workshop –** the creator of tabletop miniature games and fantasy products, softened as the shares de-rated after full-year results on concerns around softer Core revenue growth in the second half.
- **Luceco –** the manufacturer of LED lighting and electrical products, declined despite a resilient first-half trading update and some modest upgrades, as the market perhaps expected more. The unexpected retirement of the long-serving CEO added to the unease, although the board acted swiftly and appointed an experienced former manager of Halma.

Manager's comments

A solid quarter for MUSCIT, earned through company results rather than a friendly market. Consumer Staples was our strongest sector, adding 0.88% to relative performance mainly through stock selection, while Industrials detracted 1.22%.

We now have 56 companies in the Portfolio, comfortably within our target range of 55 to 60. Our preference for profitable businesses with strong balance sheets remains unchanged. As always, the challenge is finding the right balance between growth and valuation.

We are keeping an eye on position sizes. **XP Power** has been a particularly strong performer this year, but is now getting close to our preferred risk limit. A nice problem to have. We also welcomed two new companies to the Portfolio during the quarter. **Anpario** is a high-margin producer of natural animal feed additives, benefiting from the structural shift away from antibiotics in agriculture. **Fonix**, meanwhile, is a capital-light, cash-generative mobile payments and messaging business, riding the growth in more convenient payment solutions.

On the other side of the ledger, we exited three holdings. **Gooch & Housego**, which we only bought last quarter, was taken over. We sold **Craneware** as we became increasingly concerned about its regulatory and competitive environment (subsequently proven well-founded), while **Elixirr** was sold following concerns about its growth outlook and the impact of AI on a consultancy business.

Software and IT services provided an interesting contrast this quarter. **Kainos** was one of our strongest performers, with its trading update showing record backlog levels and strong demand across all divisions. **Cerillion** went the other way, falling after delays in securing new orders. We believe this is more a question of timing in converting a strong pipeline into contracts, although we will be watching the order book closely.

Outlook

The market is warming to UK SmallCap faster than it is warming to Quality as an investment style. That gap is where we see the opportunity.

Corporate buyers are certainly not waiting. Three of our holdings have been bid for over the past two quarters, the latest being **Gamma Communications** and **Gooch & Housego after we parted company with AnimalCare**. Ashtead Technology has received an approach too. Trade and private equity buyers appear willing to pay for earnings power that the public market is still reluctant to recognise. How long can this disconnect continue?

Of course, there are risks. The big question remains the cost of money. If gilt yields remain at current levels, domestic demand and businesses reliant on cheap financing will continue to face pressure. The upcoming Budget could also weigh on sentiment in the short term. We have been mindful of interest rate sensitivity for some time, which is one of the reasons we reduced our property holdings last quarter.

Quality has been out of favour for some time, but that does not mean the underlying businesses have suddenly become less attractive. Quite the opposite. Many continue to deliver encouraging results, yet their valuations have yet to respond.

We remain convinced that patient ownership of high-quality smaller companies will be rewarded.

Charles Montanaro
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