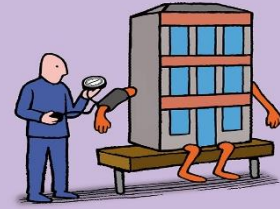


EUROPEAN INCOME FUND

Investment Commentary

Q4 2024



Market review

The final quarter of 2024 presented challenges for European equities, as concerns over slowing economic growth, rising interest rates and political uncertainty weighed on investor sentiment. While fears of a potential recession lingered, the overall economic picture remained mixed. Inflationary pressures began to ease from earlier peaks but remained above target levels, keeping policymakers under pressure to strike the right balance between growth and inflation.

Political instability in Germany and France further complicated the outlook. In Germany, the collapse of the governing coalition paved the way for elections in early 2025, while in France, the Prime Minister was ousted following a no-confidence vote, leaving political leadership in flux. The economic impact of these developments, however, was muted.

SmallCap stocks underperformed their LargeCap peers in the final weeks of the year, reflecting cautious sentiment among investors. However, the Fund's emphasis on high-quality, innovative companies in structurally growing sectors helped it deliver robust relative returns. The operational resilience of companies within the Portfolio, underpinned by strong fundamentals and long-term growth drivers, allowed the Fund to navigate the challenging environment effectively.

Portfolio

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

of 2.5% versus the composite benchmark on a total return basis (returns in £)¹. In a declining market over the past 6 months, the Fund has delivered a flat return, a relative outperformance of some 4%.

The strongest contribution during the quarter came from **MTU Aero Engines**, the German aircraft engine component supplier to RTX and one of the largest global maintenance, repair, and overhaul (MRO) providers, which advanced on continuing strong demand in its MRO business and the appointment of a new CEO, the former CEO of Lufthansa Technik, a key MRO partner. **Reply**, the leading European IT and software services business, posted strong Q3 results and raised full-year guidance. **Elmera**, the leading Nordic energy supplier, announced healthy Q3 results driven by margin improvements and operational efficiencies.

The weakest contribution came from **Warehouses de Pauw**, the Belgian real estate company focused on logistics properties, which underperformed despite solid property fundamentals and earnings meeting expectations. The underperformance was driven by a sector-wide derating, as concerns over the end of declining interest rates weighed on the broader property market. **Moncler**, the Italian luxury outerwear brand, pulled back on continuing concerns about weakness in the luxury goods sector. **Melexis**, the Belgian sensor and mixed-signal semiconductor chip provider to the automotive industry, underperformed due to an inventory overhang, delays in new vehicle launches and an anaemic automotive outlook.

Outlook

There are signs that the smaller company thaw may finally be underway. Over the last six months, European SmallCap has outperformed LargeCap by 2%, suggesting that investors are beginning to look beyond the tech giants to other areas of the market that could benefit from any wobble in their stellar performance.

The signs are positive. The Q4 earnings season has already started strongly, setting a solid foundation for the year. Valuations remain at extreme discounts compared to LargeCap, more extreme even than the gap reached during the Global Financial Crisis of 2008.

The Fund's active, bottom-up investment approach will remain essential in identifying under-researched and undervalued opportunities. The combination of a supportive valuation

¹ Please note that the Fund has multiple share classes and the factsheet should be consulted for specific return information:
<https://montanaro.co.uk/our-funds/>

environment, ongoing M&A activity and the relative resilience of our Portfolio should enable the Fund to generate attractive returns over the coming years, even in the face of uncertain macroeconomic conditions. With improving earnings growth and compelling valuations, 2025 could be the year SmallCap shines once again.

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