MONTANARO

ASSET MANAGEMENT

MUSCIT

Montanaro UK Smaller Companies Investment Trust

Quarterly review – Q4 2025

Although UK equities delivered a strong year in headline terms in 2025, this masked a challenging backdrop for Quality smaller company strategies:

- The FTSE All-Share rose by 24% in 2025, its best year since 2009, driven by LargeCap and Value, with strong performances by Banks and Metals & Mining

But SmallCap, Quality and Growth remain deeply out of favour:

- UK SmallCap trailed LargeCap by 12% for the year & by 5% in Q4*
- SmallCap "Growth" underperformed "Value" for a 5^{th} consecutive year and by 3% in the 4Q marking an unprecedented fifth consecutive year of underperformance
- Quality lagged the broader UK market by 15% in 2025, its worst year in over a decade and by 4% in Q4***
- AIM lagged the Numis SmallCap Index by 6.4% in 2025, extending its losing streak to a fifth consecutive year

Note: All returns are Total Returns in GBP.
** based on the MSCI UK SmallCap vs LargeCap indices ** based on MSCI UK SmallCap Growth vs MSCI UK SmallCap Value *** based on MSCI UK Quality vs MSCI UK Index*

MUSCIT had a tough time compared with the benchmark. Style effects were a significant headwind, as both Quality and Growth recorded some of their weakest relative performance in over a decade. "Quality" lagged the broader market by around 15% in 2025, while SmallCap "Growth" recorded a fifth consecutive year of underperformance compared to Value.

Market leadership was concentrated in areas such as financials, energy, utilities and commodity-linked stocks such as gold and copper. These are sectors where we have limited or no exposure due to concerns around balance-sheet risk, earnings volatility and the sustainability of returns.

As a result, performance during the year – and particularly in the second half – was shaped less by company-specific fundamentals and more by extreme factor and sector dispersion. The market continued to favour cyclical exposure and valuation sensitivity over balance-sheet strength and earnings durability. This created a challenging environment for a Trust focused on high-quality businesses (compounders) with long-term growth potential.

Performance & Portfolio

During the quarter, MUSCIT's NAV declined by -2.5% compared to the benchmark which rose by +2.2% (the benchmark inclusive of AIM rose slightly less by +1.6%).

The **strongest contributors** during the quarter were:

- **Games Workshop**, the creator of tabletop wargames and fantasy figures, rose after a strong trading update and revenue growth of more than 15%. They delivered the strongest results in their history.
- **4imprint**, the supplier of promotional merchandise, rose after raising its full-year revenue and profit outlook for 2025 in a positive trading statement.
- **Porvair**, the producer of filtration and separation technologies, gained following a confident December update, with management guiding to earnings marginally ahead of analyst forecasts.

The **weakest contributors** during the quarter were:

- **Baltic Classifieds**, the operator of online classified portals across the Baltic region (think Rightmove and Autotrader combined) fell amid industry-wide concerns that generative AI could prove disruptive to traditional classifieds business models, not helped by a slowdown in vehicle sales in Estonia.
- **Hilton Food**, the supplier of packaged and processed meats, issued a profit warning and cut its 2026 outlook due to weaker demand than expected and ongoing

operational challenges within its seafood division.

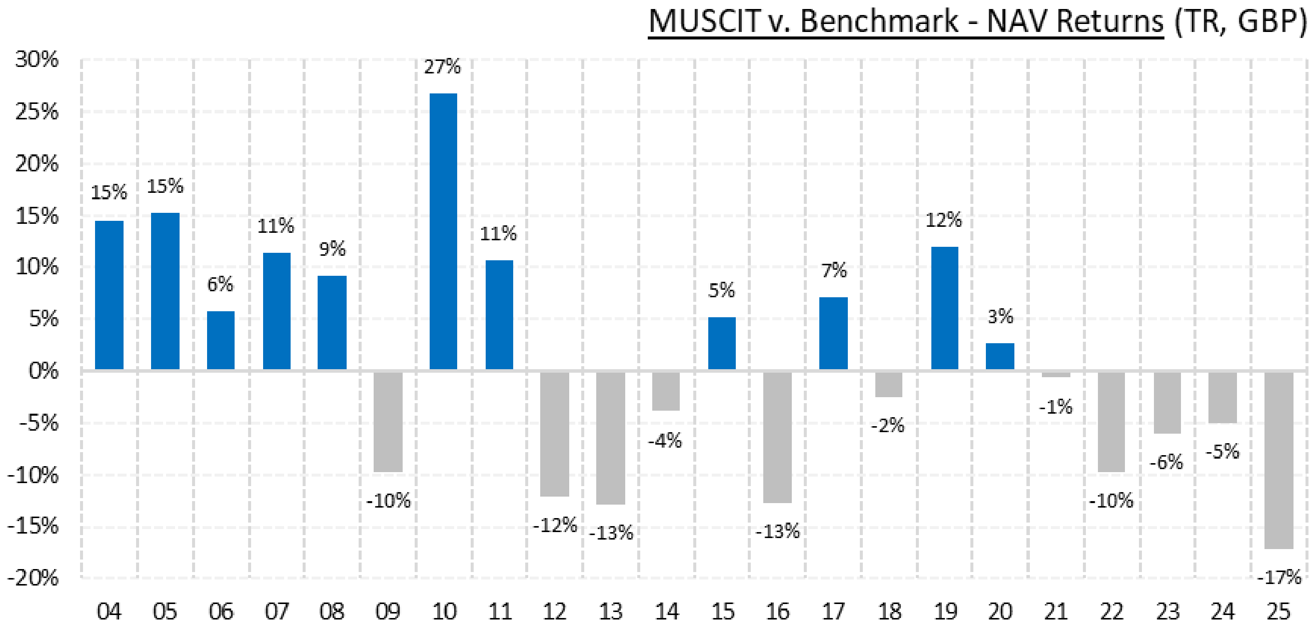
- **Cerillion**, the provider of billing, charging and CRM software for telecommunications companies, fell as the shares de-rated amid a lack of new contract win announcements and cautious sentiment after insider selling by the CEO.

Manager's comments

As a result of share buybacks by the Board to keep the discount in single digits, in share price terms MUSCIT managed to eke out a small positive return of 3%. Let's face it, this is nothing to get excited about and is much less than I have been used to over the past thirty years. It was a hugely disappointing year too in terms of relative performance against our benchmark and warrants closer scrutiny. In this commentary, we will examine the performance figures in some detail and then tell you what we have been doing. In both, we will be open about what we got right and what we got wrong; what came as a surprise leaving us wrong-footed and what we correctly anticipated.

Underperforming your benchmark by 17% is a big number in anyone's book, especially when SmallCap has underperformed LargeCap by 14% - the second highest figure since 2008.

As the chart of the MUSCIT NAV shows, it has been an unprecedented period:



Source: Internal, Numis, Bloomberg.
Based on the Cum-Income NAV with dividends reinvested.

You have heard us say on many occasions that "it is all down to style" – Quality Growth has been massively out of favour since 2021, which is why most Quality Growth Managers are so despondent as they see their 10-year long term track records being shredded. We are certainly in good company, which does not make us feel any better and is of little comfort. But is this the whole story?

One of the key lessons of recent years has been the importance of continually refining how we understand and manage portfolio risk. Risk management has always been an integral part of our investment process, but we have further strengthened our approach by investing in enhanced analytical tools. These allow us to break down more precisely both the level of risk MUSCIT is taking and the underlying drivers of returns. At a simple level, this analysis shows how much performance is attributable to broad style factors. We are, by design, Quality Growth investors, focusing on high-quality companies with strong growth characteristics. When Quality Growth as a style is significantly out of favour, there is limited scope to offset that headwind without departing from the discipline we are paid to apply. We remain convinced that Quality Growth is the right approach over the long term.

Our analysis indicates that of the 17% underperformance in 2025, 8% was down to Style. That still leaves 9% to explain. A further c.4% of relative performance reflected our lack of exposure to certain sectors that performed strongly during the year but which we typically avoid because they tend to be low growth, highly cyclical or lower quality. These include areas such as mining (for example gold and copper), banks, airlines and structurally low-margin businesses.

By the way, our only formal sector exclusions are on ethical grounds and include tobacco, alcohol, same-day lenders and gambling companies which collectively are a small part of the index.

The remaining c.5%-6% of underperformance was therefore down to stock selection (the posh term these days is "idiosyncratic risk"). Now as we are paid to add value through stock selection, I apologise for having failed to do so last year.

So how much of this was down to mistakes on our part? Which companies disappointed, issued profit warnings and were a surprise? Remarkably, only one falls into this category – Hilton Foods – as mentioned above. They saw their seafood division Foppen having a repeat problem (as in June 2024) as the cost of white fish went through the roof and they couldn't pass the inflationary pressure on. We did not see this coming. But we have a high regard for the Chair who has now taken on an executive role and the CEO has fallen on his sword. So we remain investors.

Then there are a number of companies operating in cyclical industries that we knew were having a difficult time and earnings were reduced (which came as no great surprise): housing-related companies (Marshalls and Genuit); headhunters / staffing companies as unemployment rose (SThree); retailers suffering the impact of the Budget (Greggs); train companies (Tracsis). Greggs, SThree and Marshalls have been sold, reducing the cyclicality of the overall portfolio.

The greatest surprise over the year has been the number of high quality, high conviction companies that have delivered on earnings expectations yet have seen their share prices de-rate for no good reason: DiscoverIE, Raspberry Pi, Cerillion, Gamma Communications, Bloomsbury, Baltic Classifieds. When sentiment improves towards SmallCap, we would expect these to recover. These companies account for 6% of the negative attribution.

At the risk of having depressed everyone, several core holdings surpassed our expectations and include: JTC (taken over); Games Workshop; Alpha Group (taken over); Integrafin; Tristel; Boku; and Hill & Smith. So it is not all doom and gloom.

Finally, what have we been doing? As this note enters War & Peace territory, I will be brief. During the quarter, the take-over of Alpha Group was completed and we exited Polar Capital in the belief that, if the AI "bubble" bursts, it would impact technology investors.

New investments were: Craneware (a company we owned many moons ago); Restore which we sold when Charles Skinner left and where we are delighted by his return; Filtronic as an exciting (but high risk) exposure to space and satellites; and finally the flotation of Beauty Technology Group on which we spent a huge amount of time. We rarely participate in IPOs (the last being Raspberry Pi). Since going public, they have raised their earnings and sales expectations twice. Bravo!

Outlook

Looking ahead, the backdrop for smaller companies remains challenging but increasingly asymmetric, with risks well understood and valuations reflecting a high degree of pessimism. After several years of pronounced style headwinds, 2025 marked an extreme point for the underperformance of SmallCap, Growth and Quality investing, driven by higher-for-longer interest rates, value-led market leadership and persistent outflows from domestic equities. These forces weighed heavily on portfolio returns despite broadly resilient underlying company fundamentals.

However, history suggests that periods of such prolonged and concentrated underperformance have tended to create compelling long-term opportunities. SmallCap now trades below long-term average valuation multiples and at a near-decade-low premium to LargeCap. Quality stocks are valued at levels last seen over ten years ago.

Importantly, consensus expectations point to an acceleration in earnings growth through 2026, returning to double-digit rates after three subdued years. Almost 60% of our companies have net cash. This balance-sheet strength provides resilience in a slower-growth environment. The underlying economics of many portfolio companies continue to improve, suggesting double digit earnings growth can be achieved.

From an income perspective, the enhanced dividend policy gives shareholders (including us of course) a meaningful and sustainable yield supported by both portfolio income and substantial capital reserves. At around 7%, this seems particularly attractive as we all wait for the growth to come through.

Surely a repeat of 2022 and 2025 is unlikely…our time will come.

Best of luck this year.

Charles Montanaro
January 2026

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