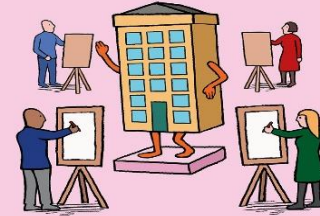


EUROPEAN SMALLER COMPANIES FUND

Investment Commentary

Q4 2024



The Montanaro European Smaller Companies Fund (“MESCF”) returned to form in 2024. The NAV rose by over 10% in €, 5% ahead of the benchmark index. Returns were driven by good stock-picking, particularly in the Industrials and IT sectors. The Portfolio experienced one takeover (following five the previous year) as Esker, the provider of cloud-based process automation solutions, was taken over at a 30% premium.

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. In contrast, the UK experienced tangible economic consequences from Labour’s budget, which had a negative effect on business activity and weighed on sentiment.

Within this context, Industrials and IT – both key contributors to the Fund’s outperformance – benefitted from long-term tailwinds such as automation, digital transformation, and infrastructure renewal. While SmallCap stocks underperformed their LargeCap counterparts in the final weeks of the year, the Fund’s focus on high-quality, innovative companies in structurally growing sectors helped it to deliver robust relative returns.

Portfolio

In Q4, the NAV of the Euro institutional distribution share class declined by 3.6%, in line with the

MSCI Europe Small Cap benchmark index on a total return basis (returns in €)¹. For the year as a whole, the NAV increased by 10%, an outperformance of 4.8%.

The strongest contribution during the quarter came from **Games Workshop**, the UK creator of the Warhammer fantasy miniatures and tabletop games, which advanced on the finalisation of the Amazon deal and entry into the FTSE 100. **MTU**, the German aircraft engine component supplier to RTX and one of the largest global maintenance, repair and overhaul (MRO) providers, advanced on continuing strong demand in its MRO business and the appointment of a new CEO, the former head of Lufthansa Technik, a key MRO partner. **Reply**, the leading European IT and software services business, posted strong Q3 results and raised its full-year guidance.

The weakest contribution came from **Hypoport**, the German provider of technology solutions for financial services, which underperformed due to lagging profitability in its Financing Platforms business, despite achieving double-digit growth in total sales as of Q3. **Melexis**, the Belgium sensor and mixed-signal semi-chip provider to the automotive industry, underperformed due to inventory overhang, delays in new vehicle launches, and an anaemic automotive outlook. **Tecan**, the Swiss manufacturer of laboratory instruments and automation solutions, suffered from continued softness in pharmaceutical CAPEX budgets and delayed government stimulus funding in China.

Outlook

It is no secret that smaller companies have been out of favour, overshadowed by the "Magnificent Seven" in the US and the less catchy "GRANOLAS" in Europe. However, there are signs that the thaw in SmallCap 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.

Looking ahead to 2025, the earnings growth outlook is promising, with consensus EPS growth for the Fund estimated at 11.7%, a significant improvement on the single-digit growth seen in 2024. The Q4 earnings season has already started strongly, setting a solid foundation for the year. Valuations in the SmallCap space remain at extreme discounts compared to LargeCap, larger 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 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.

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/>

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