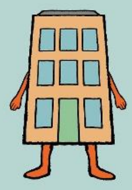
MONTANARO
ASSET MANAGEMENT

European Income Fund



Quarterly review – Q2 2025

Q2 Returns – European "SmallCap Effect" returns:

- European SmallCap outperformed LargeCap by c.4% in Pan-Europe and c.6% in Continental Europe during Q2 (EUR)
- Strong gains across the Continent, highlighting a broadening recovery

Drivers / Catalysts:

- SmallCap rebound supported by rate cuts from ECB and BoE, plus £369m inflows into European equities in May – the strongest since June 2024
- NATO's 5% defence spending pledge adds tailwind to Defence stocks

Earnings / Valuations:

- European SmallCap valuations remain compelling with P/E discounts vs. LargeCap still near 20-year lows
- Relative earnings momentum stable; growth remains subdued in Europe but improving signs globally, especially in US-led AI and Semis segments

The first half of 2025 saw a welcome resurgence in European SmallCap markets, reigniting investor interest after years of muted returns. The return of the "SmallCap Effect" showcased many of the structural advantages that make smaller companies compelling: greater inefficiencies arising from limited analyst coverage, potential for operational leverage and the agility to adapt to shifting economic conditions.

Encouragingly, the Fund delivered strong absolute and relative returns during the second quarter, despite having minimal exposure to the exceptional performance of the European

Aerospace & Defence sector, which has surged +127% in Continental Europe since the start of the year.

Performance was driven by effective stock selection in Materials — notably **SOL** and **Borregaard** — alongside positive contributions from holdings such as **Kitron**, **Melexis** and **Cembre**. Our disciplined investment approach, centred on profitable, dividend-paying companies with robust balance sheets, continues to underpin the Fund's ability to navigate periods of market volatility.

Portfolio

During the quarter, the NAV of the Sterling Share class increased by 10%, an outperformance of 2.8% relative to the IA Europe ex UK benchmark index (in total return terms).

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

- **Kitron** – the Norwegian electronics manufacturing services (EMS) company advanced as increased exposure to defence supported a re-rating. The group announced several contract wins and continues to benefit from a strong and growing order book.
- **SOL** – the Italian manufacturer of industrial gases and provider of medical homecare solutions continued to re-rate, closing the valuation gap with global peers such as Linde and Air Liquide.
- **Cembre** – the Italian producer of electrical connectors and tools for industrial applications delivered consistent revenue growth and maintained high margins, demonstrating resilience against cost pressures during the quarter.

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

- **Azelis** – the specialty chemicals distributor lagged after Q1 results showed weakened performance, with some operational pressures emerging in specific business areas.
- **AAK** – the producer of high-value-added vegetable oils and fats lagged after reporting softer volumes.

- **Thule** – the Swedish premium brand specialising in roof boxes, bike racks and strollers softened as US consumer sentiment remained cautious. The company also increased product development investment in a bid to support future sales through innovation.

Outlook

Looking ahead, we believe the environment remains favourable for high-quality, income-generating European smaller companies. Rate cuts in Europe are providing a supportive backdrop for equities, while investor sentiment continues to shift towards undervalued smaller companies after years of neglect. We are actively monitoring opportunities to add to areas like Materials, Healthcare, or Industrials to further diversify the portfolio, while remaining vigilant on liquidity and company-specific execution risks.

By maintaining our emphasis on potential total return, blending both yield and capital growth, we believe the Fund is well-placed to deliver attractive, risk-adjusted returns from European SmallCaps to our investors.

Alex Magni
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