MONTANARO

ASSET MANAGEMENT

# MESCT

*Montanaro European Smaller Companies Trust*

## Quarterly review – Q3 2025

**Risk-on quarter:**

- Equities rallied across Europe ex-UK
- Gold posted a standout quarter (+19.3%)
- SmallCaps underperformed LargeCaps by around 2% in Europe ex-UK*

**Quality continued to underperform:**

- Quality has lagged by more than 12% over 12 months in Europe

**Clear preference for Value:**

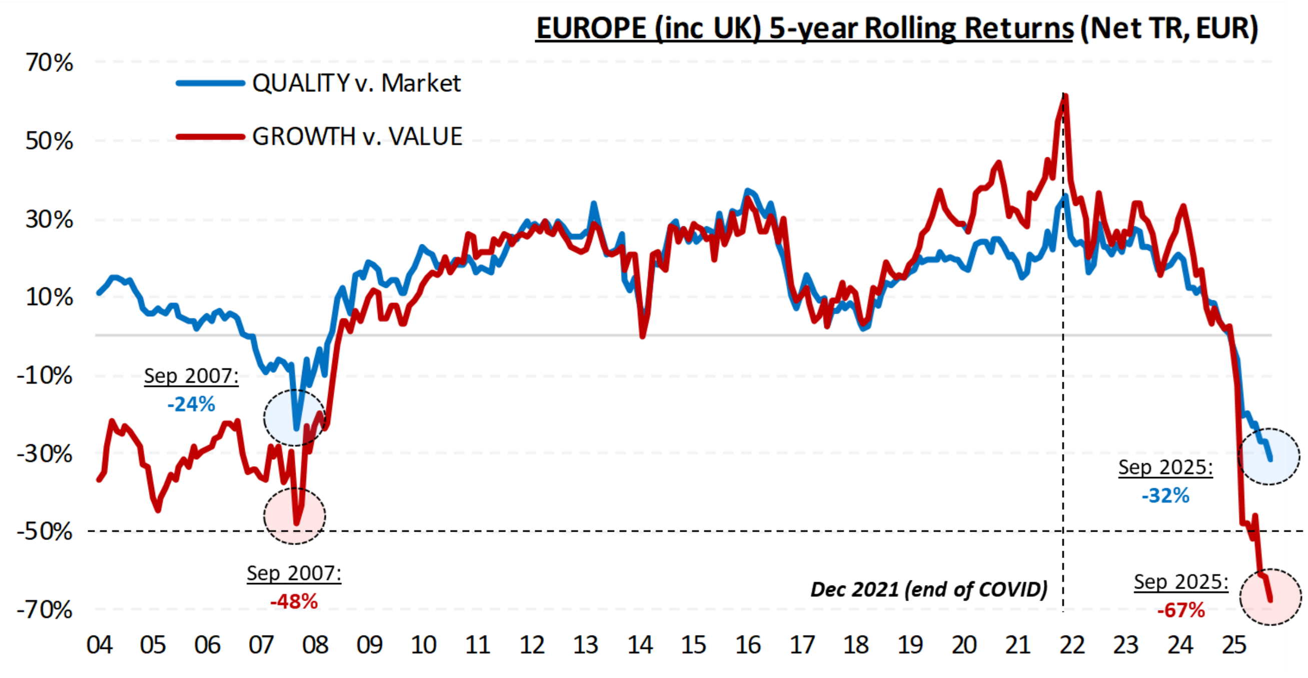
- 9% underperformance of Quality versus Value in Europe ex-UK

*Note: All returns are Total Returns in GBP.*
**Based on the MSCI Europe ex-UK SmallCap v. LargeCap indices*

**The third quarter of 2025 proved to be an exceptionally difficult environment for our "Quality Growth" style.** Equity markets across Europe pushed higher, with cyclical and more speculative areas leading the advance, while defensive sectors, profitable companies and Quality Growth underperformed sharply.

Gold also had a standout quarter, supported by hedging against inflationary and macroeconomic concerns and by investor "fear-of-missing-out".

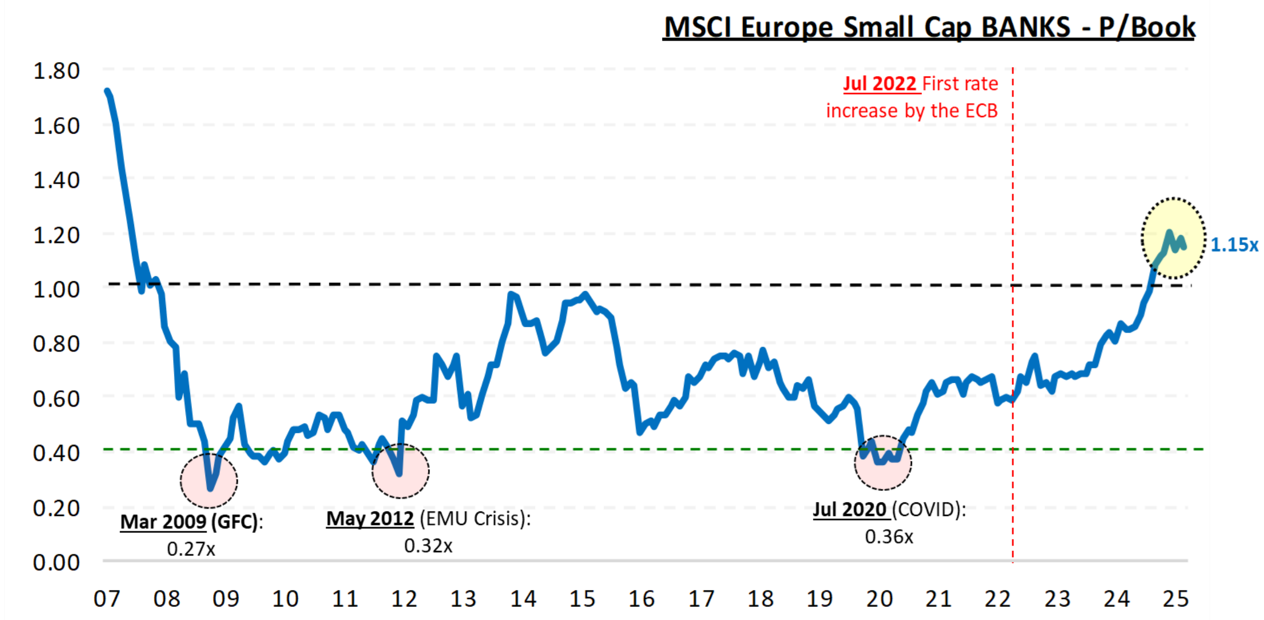
Within Europe, defensive and higher-quality businesses lagged as Value areas of the market rallied. As shown below, Europe's Quality style has endured an unprecedented period of underperformance. On a five-year rolling basis, Quality has now lagged the market by over 30% — the weakest relative performance in more than two decades. Growth, meanwhile, has fared little better, underperforming Value by almost 70% over the same horizon. This divergence reflects the deep market preference for cyclicality and short-term earnings leverage rather than for companies with resilient profitability and balance sheets.




Source: Montanaro Asset Management, MSCI, Factset.
Indices used are: MSCI Europe Quality Index, MSCI Europe Index, MSCI Growth Index, MSCI Value Index (all in EUR).

Sector leadership in Europe ex-UK SmallCap continued to reflect investors' preference for Value, with Airlines, Biotech, Marine Transportation, Metals & Mining, Autos and Telcos among the best-performing sectors, while Financials delivered its twelfth consecutive quarter of gains.

In contrast, Consumer Staples (-23% relative), Health Care (-14%) and IT (-12%) have been the weakest performers year-to-date. Banks, in particular, have benefited from the higher-for-longer interest rate environment, with European SmallCap banks now trading at over 1.1x book value — their highest level since before the Global Financial Crisis. The Portfolio's structural underweight to this area proved a headwind.




Source: Montanaro Asset Management, MSCI, Factset.

In short, this was a quarter that rewarded cyclical risk-taking over steady profitability. However, periods of extreme dispersion such as this have historically preceded strong recoveries in Quality investing. We remain confident that the fundamentals of our holdings — high returns on capital, robust balance sheets and strong structural growth potential — will ultimately be rewarded as market leadership normalises.

# Portfolio

During the quarter, the NAV total return of MESCT was -3.1% in GBP, an underperformance of 6.2% relative to the MSCI Europe SmallCap (ex UK) Index.

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

- **Plejd** – the Swedish developer of smart lighting and home automation solutions gained as it continued to deliver impressive organic growth, supported by new product launches and international expansion.

- **Pfisterer** – the German provider of grid technology solutions advanced on strong demand for its products supporting electricity grid infrastructure upgrades.

- **Merlin Properties** – the Spanish real estate company gained as it reported stronger operating metrics (office occupancy at record levels, like-for-like rent growth and data centre & logistics progress) and upgraded its outlook.

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

- **ATOSS Software** – the German provider of workforce management software drifted after reporting soft order intake at its half-year results and was caught up in the global SaaS sell-off during the quarter. Encouragingly, the Founder and CEO purchased €6m of stock towards the end of the period.

- **CTS Eventim** – the leading ticketing provider in Europe weakened after Q2 results were impacted by M&A integration costs, with management reiterating guidance at the lower end of the full-year range.

- **Amadeus FiRe** – the German recruitment and skills training company declined after issuing a significant profit warning amid very weak labour demand and disruption to government-sponsored training programmes.

# Outlook

Markets today are being driven less by fundamentals and more by momentum, hype and fear of missing out. Investor psychology has tilted towards chasing what has worked, regardless of valuation. The rally in AI-related equities is a case in point: capital continues to flow into a narrow group of MegaCap names, while the broader market has struggled.

We have seen this before. Periods when a handful of themes or sectors dominate market performance tend to coincide with the later stages of a cycle. Value shares often outperform when economic data strengthens or when inflation expectations rise, while Quality businesses can lag temporarily. This is a normal part of the investment cycle.

History suggests that such phases do not last indefinitely. When enthusiasm fades and markets begin to refocus on earnings, cash generation and balance sheet strength, companies with durable business models and pricing power tend to reassert their leadership.

As we wrote recently in our blog on passive dominance, the rise of passive vehicles has only amplified these cyclical extremes. Inelastic market behaviour means flows now dictate price levels more than fundamentals. Yet when momentum unwinds, fundamentals reassert themselves – and active, bottom-up stock picking returns to the fore.

Against this backdrop, we remain focused on our areas of expertise. We have strengthened our process in recent years, tightening risk management and refining portfolio construction, while ensuring that our team is well resourced and spending as much time as possible speaking to management teams.

We continue to believe that investing in Quality, growing businesses with strong balance sheets and sustainable competitive advantages is the best way to compound capital over time. **The Trust's long-term track record** (**an annualised return of over 12% over the last ten years, over 4% more than that of the benchmark**) **supports this view.** Markets do not stay the same forever; they change when investors least expect it. When this happens, our disciplined and patient approach should be well placed to benefit.

***George Cooke***
*October 2025*

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