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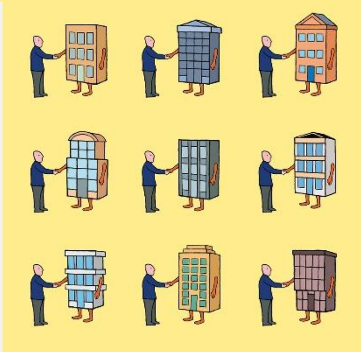
ASSET MANAGEMENT

The UK Income Strategy

- Montanaro UK Income Fund (Dublin)
- WS Montanaro UK Income Fund (UK)

Quarterly review – Q1 2026



Key points:

- February 2026 saw the **first inflow into UK AllCap funds in 5 years**.
- The war in Iran bolstered energy and defence exposed FTSE 100 constituents; **SmallCap lagged Large by >10%***, while Quality underperformed the market by 7%*.
- Valuation gap further widened; **UK SmallCap now at a near 20-year P/E low** relative to LargeCap – an ever-more-attractive entry point.
- **Strong idiosyncratic stock performances** led to the Fund delivering healthy outperformance vs FTSE 250 (ex-Investment Trusts) of 3.2%.
- **2026 Fund distribution forecast upgraded**; 12m forward yield of 4.2% at the top end of historical range.
- The Fund was trading at its lowest ever P/E of just 13.5x at the end of March.

* Based on MSCI indices

Paraphrasing Vladimir Lenin, there are decades when nothing happens; and quarters when decades happen. The first quarter of 2026 appears to be such a moment.

Geopolitics provided a volatile backdrop, but for much of the quarter market behaviour was driven less by individual events and more by the continuation of established themes from 2025. January and February saw a clear extension of three dominant trades: the bifurcation within AI (hardware beneficiaries outperforming software), the debasement trade, and a strong bid for minerals relative to oil. Against this backdrop, developments in Venezuela and Greenland, while notable politically, had limited direct impact on markets.

The inflection point came in late February with the escalation of tensions between the US, Israel and Iran. Unlike earlier geopolitical developments, this proved decisive. The conflict triggered a sharp and disorderly repricing across asset classes, with energy markets at the epicentre. Oil prices surged, shipping rates spiked and inflation expectations moved higher, driving volatility in bond yields and risk premia. Traditional diversification proved less effective, with both gold and cryptoassets offering limited protection during the sell-off.

The Iran shock inverted several of the prevailing market dynamics. Oil outperformed while industrial metals weakened, financials came under pressure on recession concerns, and within technology the AI trade partially flipped — hardware lagged while more asset-light software businesses proved relatively more resilient. Earlier in the quarter, advances in "digital co-workers" had already driven an indiscriminate sell-off in software, contributing to a broader derating across growth equities and a reassessment of capital allocation by the largest technology companies.

Against this backdrop, UK equity markets delivered a mixed start to 2026, with headline index performance masking a significant divergence beneath the surface. While the FTSE 100 delivered a positive return of +3.4%, UK SMidCap indices were notably weaker, with the FTSE 250 declining materially (-5.1%) and Numis UK SmallCap (ex-IT) index falling further (-6.9%).

Much of the weakness occurred later in the quarter, as higher energy prices and renewed concerns around inflation led to higher bond yields, which weighed on market sentiment (especially in the more domestically orientated SMidCap part of the market).

Q1 2026 therefore extended the prolonged period of SmallCap underperformance. Indeed, UK SmallCap is now at a near 20-year PE low relative to LargeCap, representing an ever-more-attractive entry point for an asset class that has historically outperformed and whose growth prospects remain attractive.

In addition to the size headwinds discussed above, style factors also continued to be a headwind to the Fund's positioning over the period, with UK Quality declining by 7% versus the market and UK SmallCap Growth dropping by 3% versus Value.

Performance & Portfolio

During the quarter, the NAV of the Sterling seed share class of the **Dublin domiciled Fund** declined by 2.5%, compared to a benchmark return (IA All Companies Sector) of -1.9%. **Nevertheless, compared to the FTSE 250 (ex-Investment Trusts), which has a more comparable market cap profile, the Fund outperformed by 3.2%.**

The NAV of the sterling income share class of the **UK domiciled Fund** declined by 2.1% during the quarter.

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

- **Bloomsbury Publishing** – the UK publisher of fiction, non-fiction and academic titles rose after announcing that the next two novels from Sarah J. Maas will be published later this fiscal year.
- **XP Power** – the provider of power control solutions advanced following strong results evidencing growing demand across all three of its core segments.
- **Clarkson** – the UK shipping services provider specialising in broking, finance and research gained as it is expected to benefit from higher freight rates resulting from events in Iran.

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

- **Big Yellow** – the UK provider of self-storage solutions weakened as bond yields increased in March and events in Iran may impact consumer and business confidence in the UK.
- **discoverIE** – the UK designer and manufacturer of customised electronics for industrial applications declined as it was caught up in the broader industrial sell-off following escalations in the Middle East.
- **XPS Pensions** – the UK pensions consultancy and administration provider drifted on no specific news.

Engagement & ESG

XP Power – UK-based manufacturer of power control solutions

We engaged with XP Power following a media report alleging that its components had been identified in Russian and North Korean weaponry, with the aim of clarifying the nature of this exposure and assessing the robustness of its sanctions compliance framework. The company explained that the report conflates previously identified components in captured equipment, which it believes were either sold prior to the 2022 invasion or may be counterfeit, with more recent shipment data suggesting exports from Hong Kong to Russia, which it attributes to indirect resale through complex and opaque supply chains. XP confirmed that it has not sold directly to the entities identified, nor through authorised distributors, and highlighted steps taken since 2022 to strengthen export controls, including enhanced due diligence, sanctions screening and tighter distributor oversight. While these measures represent progress, the engagement also highlighted the inherent challenges in maintaining full traceability and control over downstream distribution. We will continue to monitor developments relating to distribution controls and geopolitical exposure.

Outlook

While many of the style dynamics witnessed in recent years played out again in Q1 2026, with SmallCap, Quality and Growth all underperforming, we look to the future with optimism. This is due in part to the ever-more-attractive valuation starting point for our companies. Indeed, at the end of March, the Fund was trading at its lowest ever P/E of just 13.5x. Furthermore, the relative P/E of UK SmallCaps vs LargeCaps is now at close to a 20-year low.

Extreme negativity is being priced in for high-quality UK SmallCaps. Yet there is a disconnect between valuations and what our companies are saying in their trading updates. The vast majority of the Fund's holdings delivered trading updates that were in line or better than expectations during Q1, and they are expected to grow earnings at double-digit rates over the next year.

Corporates and PE houses continue to notice this disconnect; after a feverish 2025 for M&A, bids for UK SmallCaps have continued apace into 2026. With valuations at such depressed levels, we would expect this trend to continue (notwithstanding the geopolitical uncertainty caused by the situation in the Middle East).

Encouragingly, it's now not just potential acquirers that are looking to increase their exposure to UK businesses. Indeed, for the first time in five years, February 2026 saw net inflows into UK AllCap funds. While these flows have not yet supported SmallCaps, after years of persistent outflows from the UK market (which has created a technical overhang to share prices), perhaps we are approaching the end of this dynamic.

It has been pleasing to see several strong idiosyncratic stock performances in the Fund in Q1 2026, which has driven an outperformance of 3.2% vs the FTSE 250 (ex-Investment Trusts). This outperformance is particularly pleasing given the Value-tilted nature of the FTSE 250 (in contrast to the Fund's Quality focus, which was a major style headwind in Q1). In particular, several companies which were detractors in previous periods have delivered strong updates and been rewarded with good share price recoveries.

Overall, the Fund is yielding over 4% (well ahead of the FTSE AllShare) while offering double-digit earnings growth and while trading at all-time-low P/E. We believe the opportunity for UK SMidCaps in general, and the Fund in particular, is increasingly compelling.

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