

MONTANARO

Monthly Fact Sheet: May 2010

Montanaro, an independent specialist fund manager, was established in 1991 to research and invest in UK and Continental European quoted SmallCap companies. Funds under management are currently c. £850 million. The Focus Fund mainly invests in UK quoted small companies below £1 billion in size. A limited number of collective investments may also be held. The objective is long-term capital appreciation of at least 10% p.a.

Monthly Review

In May the Fund NAV per share fell by 6% outperforming the FTSE SmallCap Index (ex IT) by over 2%. In 2010, the NAV has risen by 2.3% compared to the 3.4% fall in the FTSE SmallCap Index (ex IT).

"Sell in May and go away until St Ledger Day" (September) is the old adage that has proved very accurate this year. After the strong recovery seen by Smallcap indices in previous months, investor appetite for risk changed suddenly as seen by the compression of bond yields in the major European economies (down 11% or 30+bps) and Gold moving above \$1200. Sterling fell by around 5% against the Dollar but strengthened by nearly 3% against the Euro in the month. The FTSE SmallCap (Ex IT) index saw a 10% retrenchment from its recent highs and only late in the month did it recover somewhat. Increasing concern that we may experience a double dip recession combined with the anticipated downgrading of Spain by Fitch (confirmed late in the month) were the principal reasons for the weakness. On a more positive note, this is starting to give UK companies a real advantage in international markets whilst the positive translation of overseas earnings was also a key feature of a number of strong Q1 trading statements.

Amongst the best performers this month was **Carclo**, which has some interesting touch screen technology but perhaps more importantly, in the short term at least, is rumoured to be on the verge of being promoted to the FTSE SmallCap index. Similarly **Dialight**, which rose 12%, may also get promoted. It has also been benefiting from strong demand in the LED lighting sector as well as being a beneficiary from

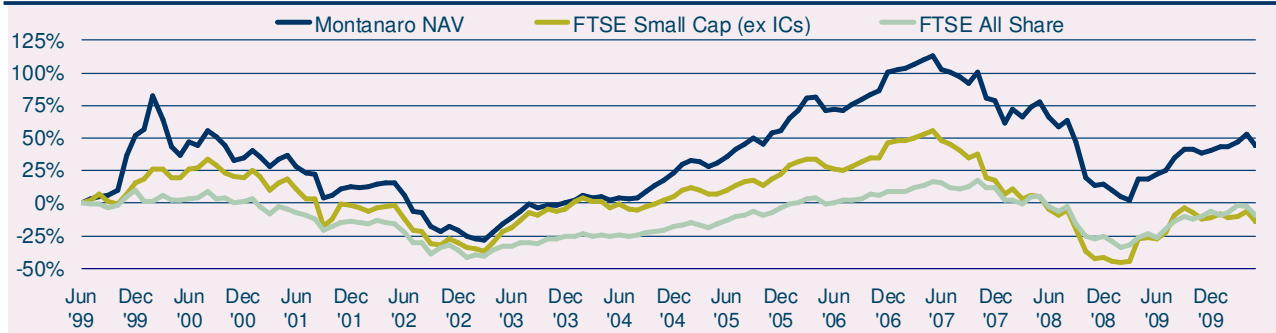
the Sterling's weakness. Finally, **Severfield Rowen** also performed well. Whilst management are still cautious, the next recovery will also be supplemented by its Indian operations which are set to move into profit next year.

On the downside **Ricardo**, the UK based automotive design engineering company, announced that H2 will not meet expectations due mainly to increased competition leading to some price pressure. **Scott Wilson** suffered as investors considered its large exposure to UK public spending to be at risk. **RPS**, experienced some profit taking following Director share sales associated with potential changes in capital gains tax. Its exposure to the oil sector may have contributed to its weak performance.

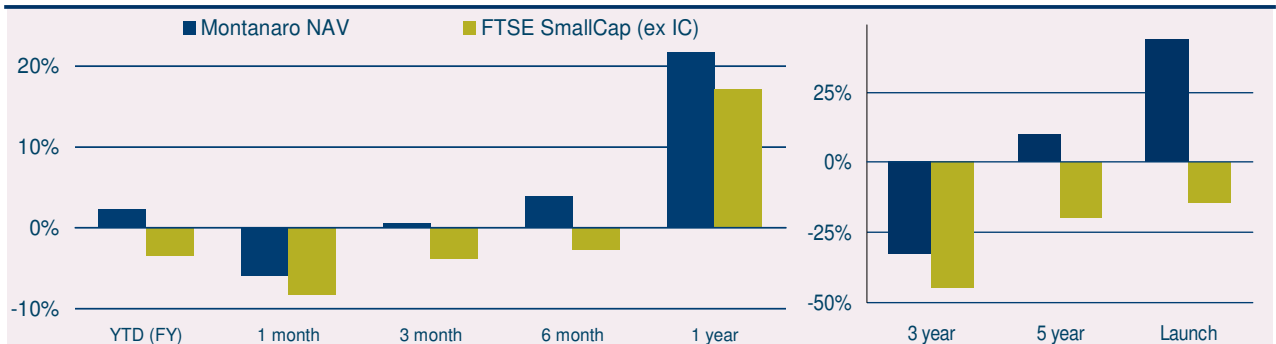
So will investors have to wait until St Ledger day? Valuations would appear to be discounting a downturn at a time when analysts are still upgrading forecasts after Q1 results. The weakness of Sterling is starting to benefit exporters and this is now encapsulated in forward valuation multiples which are standing at a 15% discount to their long term average. We expect volatility to remain high as we progress through the quieter summer period at a time when the government looks to reduce spending. The continued positive nature of most Q1 trading statements reinforces our optimistic view on the SmallCap market.

It remains noteworthy that SmallCap continues to outperform LargeCap by a wide margin. This should come as no surprise since it is entirely consistent with history.

Fund Performance



Relative Performance



Fund Performance

Y/E: December	YTD (FY)	1 month	3 month	6 month	1 year	3 year	5 year	Launch
Montanaro NAV	2.3%	-5.9%	0.5%	3.9%	21.7%	-32.5%	9.9%	43.7%
FTSE SmallCap (ex IC)	-3.4%	-8.2%	-3.8%	-2.7%	17.1%	-44.8%	-19.5%	-14.2%

Source: Montanaro, Bloomberg. NAV to NAV

Fund Analysis

	Fund	Index
Latest Price / NAV	1243.8	2248.6
Alpha (annual) *	-1.1%	na
Beta *	0.64	1.00
Standard Deviation *	21.3%	30.8%
Sharpe Ratio *	-0.83	-0.78
Tracking error *	13.8%	na
P/E 11F _†	11.3	8.8
EPS Growth 11F _†	14.7%	11.8%
Dividend Yield 10F _†	3.0%	3.5%

* risk statistics over three years † Source: Factset consensus estimates

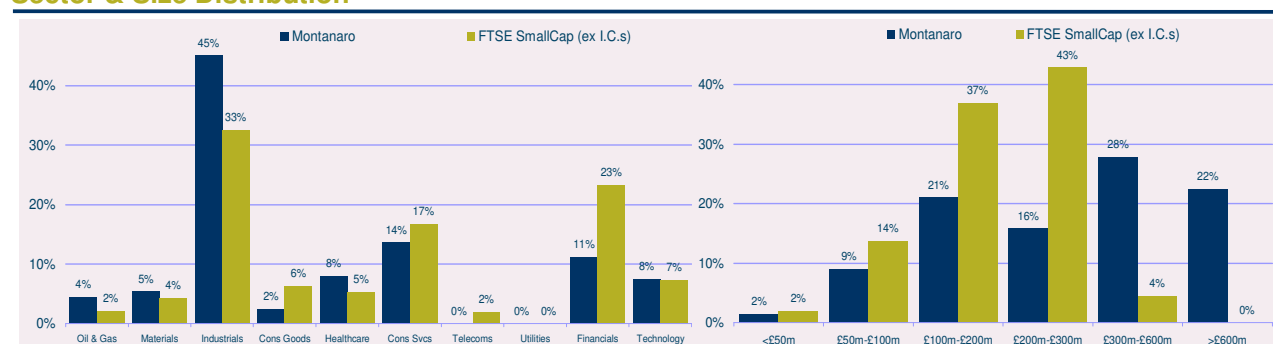
Fund Details

Launch Date	June 1999
Fund Size	£7m
No. of holdings	52
Mgmt Fee	Annual 1.5%
Perf Fee	See below*
Legal Status	Offshore (Cayman) Unit Trust
Valuation	Each Friday
Offering memo	March 1997

Top Ten Holdings

Name	Sector	% of portfolio
1 Chloride	Electronic & Electrical Equipment	3.2%
2 Domino Printing	Electronic & Electrical Equipment	2.9%
3 Dechra Pharmaceuticals	Pharmaceuticals & Biotechnology	2.7%
4 Domino's Pizza	Travel & Leisure	2.6%
5 Ncc	Software & Computer Services	2.5%
6 Ultra Electronics	Aerospace & Defense	2.5%
7 Wsp	Support Services	2.5%
8 James Fisher	Industrial Transportation	2.4%
9 RPS	Support Services	2.4%
10 Chemring	Aerospace & Defense	2.3%
TOTAL		25.9%

Sector & Size Distribution



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* Performance fee is calculated at 20% of the returns over a hurdle rate of 10%