



Even Buffett is buying euro small caps now, says AAA-rated Montanaro

By Philip Haddon | 12:53:14 | 03 June 2008

Boutique founder Charles Montanaro has told Citywire he expects quality growth to outperform 'value dogs' in Europe. He has overweighted the UK and Finland, while corporate finance activity has been boosting the performance of his European small cap fund.

The AAA-rated manager of the Montanaro European Smaller Companies fund has recovered well this year, after a savage end to 2007 for the small and mid cap sector when he says there was an indiscriminate mark down of anything deemed to be cyclical.

The fund lost 25.5% between the end of October and the end of January, but since then has recovered to gain 19.3% while the index has risen 10.5%.

London-based Montanaro attributes part of this upturn to an increase in mergers and acquisitions. 'We have seen a surprising amount of corporate finance related activity,' he says, highlighting an offer for SMIT International and rumours of an approach for agricultural services firm Genus, both of which are holdings of his.

'In general, some high quality companies have become attractively valued and have been noticed by opportunistic trade buyers. We have benefitted from this trend,' he says.

The remainder of the year will be difficult the founder of the Montanaro boutique thinks, but he believes his experience and research capability will give him an advantage.

'This will be a testing time and should sort out the men from the boys: profit warnings will be harshly punished as other stocks simultaneously hit new highs,' he says. 'Those with an in-house research capability who are not broker led should fare better than others. A few grey hairs may well be helpful.'

He says he has stayed true to his style throughout the volatility and thinks his focus on quality companies in growth sectors will pay dividends in current market conditions.

'We are conservative, we only invest in profitable companies with strong balance sheets and high margins with an emphasis on quality companies in growth sectors,' he says. 'Quality growth should outperform value, or "value dogs" as we call them. Everything is bottom up stock picking. Even Warren Buffet is looking at European small caps these days.'

Montanaro is currently overweight in consulting engineering companies which supply services to the global infrastructure boom, which he thinks will continue for many years yet. He is 10% overweight in the UK compared to his index. 'Contrary to the doom and gloom merchants in the press, there are several niche UK companies that are not cyclical that offer good value.'

But his largest relative overweight is in Finland which he likes for its exposure to

Russia.

Despite 'luckily' calling the top of the property market in 2006, Montanaro is not attempting to time the bottom of the market for financials or property. 'We prefer to stick to sound stock selection to add value.'

He thinks the disparity between the price of energy or commodity stocks and financials shows the market is 'schizophrenic' at the moment, but he is not about to make the switch into unloved financials.

'The time will come when fund managers will be right to switch from the former tin to the latter,' the AAA-rated manager says. 'We have not the faintest clue when that will be, but are vigilant.'

Despite uncertainty hovering over the rest of this year, Montanaro is looking forward to 2009.

'If small cap markets remain lacklustre or down this year that will be the second year in a row,' he says. 'In 54 years we have never experienced three consecutive years of negative real returns from small caps. So 2009 could be an interesting year.'

Over five years the Montanaro European Smaller Companies fund has returned 190% while the MSCI Europe Small Cap index has risen 142%,

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