

European Smaller Companies Trust

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 €1 billion. The European Smaller Companies Trust invests in quoted European (excluding UK) companies with a focus on companies below €1 billion in size. It is listed on the London Stock Exchange.

Monthly Review

In May the Fund NAV per share fell by 8% outperforming the benchmark by over 3%. In 2010 the NAV has risen by 1% whereas European LargeCap has fallen by nearly 10%.

"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. The Euro fell by around 7% against the Dollar in the month. In Europe the MSCI SmallCap index (EUR) saw a 16% 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 European 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.

The European Commission's economic sentiment indicator declined to 98.4 last month from 100.6 in April, leading to concerns that the rate of recovery may be more subdued. Manufacturing in the Eurozone picked up again last month but at a far slower rate than in April. Finally, the unemployment rate now exceeds 10%, the highest since the euro came into being in 1999, with some 16 million people now out of work in the Eurozone area.

This was a month when investing in quality companies was rewarded in terms of relative performance. Amongst the best performers once again was **Victrex** as the market upgraded forecasts following very strong results. The weakness

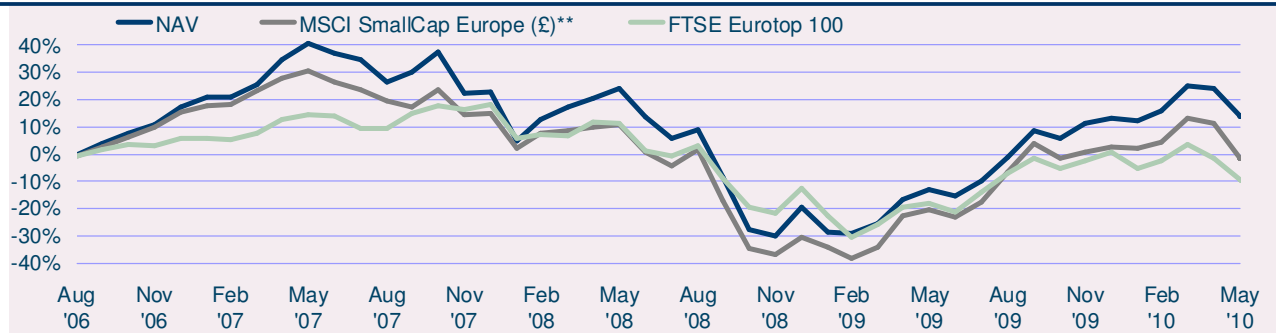
of Sterling has also been an important factor behind the concerted recovery that the company has experienced. One of our more recent purchases, **Diasorin** (based in Italy, diagnostic testing in the healthcare sector) also performed well, again benefiting from better than forecast Q1 performance. Other strong performers include **Nokia Renkaat** which bounced back after falling in April; **Viscofan** (artificial cases for the meat industry) and **Fielmann** (German Optician).

On the downside, Norwegian based **TGS Nopec** suffered as a result of the BP disaster in the Gulf of Mexico. Clearly this will have some short term impact on the requirement for seismic surveys but, in the longer term, the need for better information and continued demand for Oil will benefit the company. **Fugro** fell for similar reasons whilst **Arcadis** Q1 results disappointed the market following weaker than expected recovery in the US.

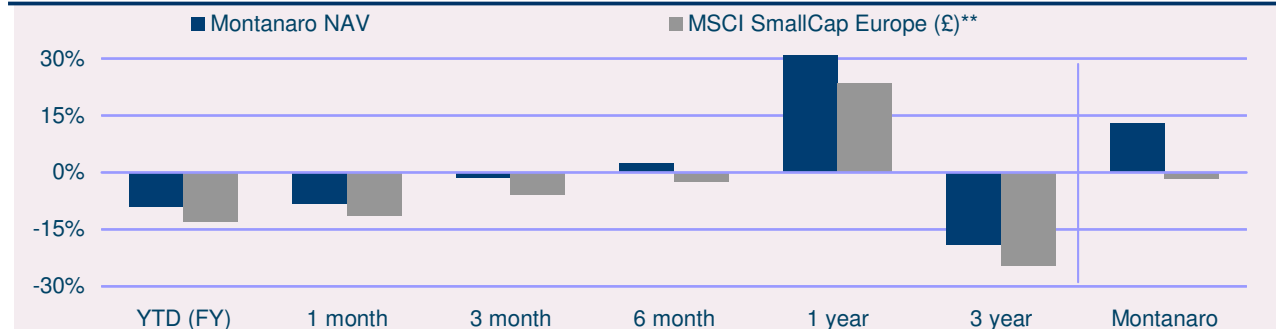
So will investors have to wait until St Ledger day? Valuations would appear to be discounting a downturn at a time when analysts are still upgrading forecasts after Q1 results. The weakness of European currencies is starting to benefit exporters and this is now encapsulated in forward valuation multiples 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 governments look to reduce spending. The continued positive nature of most Q1 trading statements reinforces our optimistic view on the European SmallCap market.

It remains noteworthy that European 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



**Effective June 1st 2009 the index used in this factsheet for comparison purposes is the MSCI European Smaller Companies Index ex-UK. The performance history prior to June 1st 2009 remains the MSCI European Smaller Companies Index.

Fund Performance

Y/E: March	YTD (FY)	1 month	3 month	6 month	1 year	3 year	5 year	Montanaro
Montanaro NAV	-8.9%	-8.3%	-1.4%	2.6%	30.9%	-19.0%		13.1%
MSCI SmallCap Europe (£)**	-13.0%	-11.6%	-5.8%	-2.4%	23.4%	-24.6%		-1.7%

Source: Montanaro, Bloomberg. NAV to NAV, fully diluted **see footnote on previous page

Fund Analysis

	Fund	Index
NAV	386.7	144.2
Share Price	348.0	na
Discount	-10.0%	na
Alpha (annual) *	2.0%	na
Beta *	0.93	1.00
Standard Deviation *	28.0%	28.4%
Sharpe Ratio *	-0.38	-0.46
Tracking error *	9.3%	na
P/E 11F _†	13.0	10.8
EPS Growth 11F _†	19.9%	23.1%
Dividend Yield 10F _†	2.8%	2.8%

* risk statistics over three years † Source: Facts&figures estimates

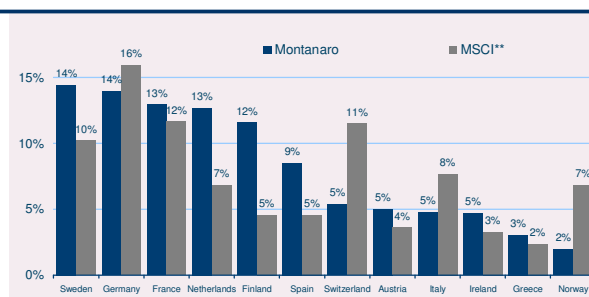
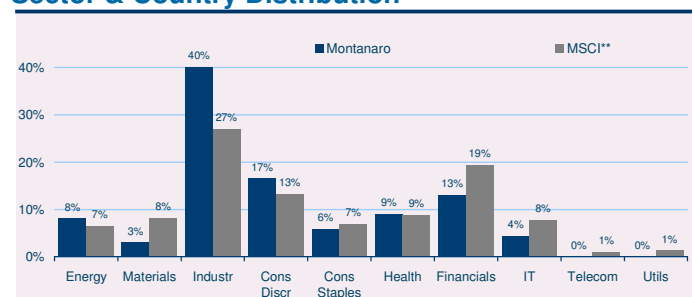
Fund Details

Managed Since	September 2006
Gross Assets	€84 million
Net Assets	€76 million
Net Gearing	11.4%
No. of holdings	49
Median Mkt Cap	€1227 million
Mgmt Fee	Annual 1%
Perf Fee	See below*
Legal Status	UK closed-end Investment Trust
Listing	London Stock Exchange
Valuation	Daily
Dividends	January and July

Top Ten Holdings

Name	Country	Sector	% of portfolio
1 Af Group	Sweden	Professional Supplies	3.4%
2 Prosegur	Spain	Commercial Services & Supplies	3.3%
3 Viscofan	Spain	Food & Staples Retailing	3.2%
4 Andritz	Austria	Machinery	3.2%
5 Frigoglass	Greece	Machinery	3.1%
6 Fuchs Petrolub	Germany	Chemicals	3.0%
7 Virbac	France	Pharmaceuticals	3.0%
8 Gfk Ag	Germany	Professional Supplies	3.0%
9 Vopak	Netherlands	Transportation Infrastructure	2.9%
10 Arcadis	Netherlands	Construction & Engineering	2.9%
TOTAL			30.9%

Sector & Country Distribution



**see footnote on previous page

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*Performance fee is calculated at 15% outperformance of MSCI European SmallCap Index Excluding UK (£) plus 2%, capped at 2%, high on high