

UK Smaller Companies Investment Trust (Capital Returns)

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 Small/MidCap companies with particular expertise in “smaller” companies. Funds under management are c.£850 million. The UK Investment Trust invests in quoted UK companies with a market capitalisation lower than the largest constituent of the Hoare Govett Smaller Companies Index (the smallest 10% of the UK stock market) focused on “smaller” companies.

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 3% compared to the 3% 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.

Again the Fund benefited from the increased corporate activity with **Kewill** (software for global trade and logistics companies) receiving an indicative bid at 130p, a premium of some 30%. Also 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, 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.

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. **Keller**, (ground engineering) experienced an unwelcome profit warning as recovery in the US remained disappointingly slow.

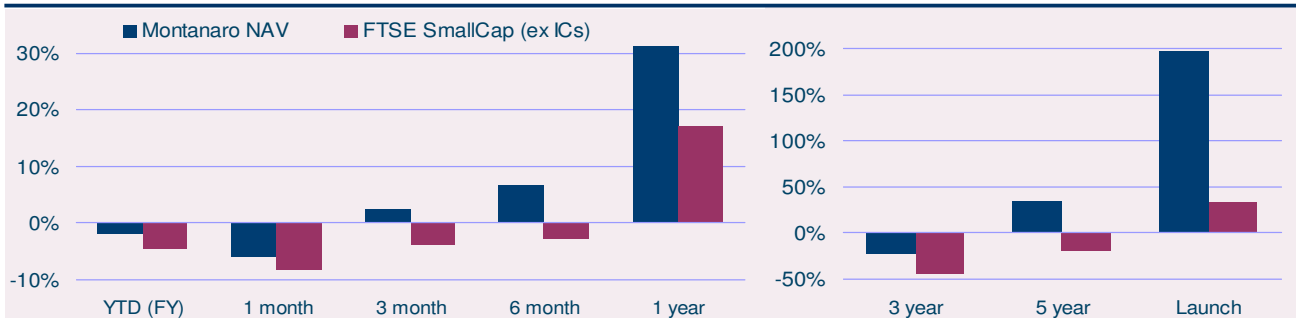
So will investors have to wait until St Ledger day? Valuations would appear to be discounting a downturn at a time when analysts are still upgrading forecasts after Q1 results. The weakness of Sterling is starting to benefit exporters and this is now encapsulated in forward valuation multiples which 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



Y/E: March	YTD (FY)	1 month	3 month	6 month	1 year	3 year	5 year	Launch
Montanaro NAV	-1.9%	-6.0%	2.5%	6.8%	31.3%	-22.8%	34.8%	197.1%
FTSE SmallCap (ex ICs)	-4.5%	-8.2%	-3.8%	-2.7%	17.1%	-44.8%	-19.5%	32.6%

Source: Montanaro, Bloomberg. NAV to NAV

Fund Analysis

	Fund	Index
NAV	292.9	2248.6
Share Price	244.0	na
Discount	-16.7%	na
Alpha (annual) *	4.8%	na
Beta *	0.71	1.00
Standard Deviation *	23.2%	30.8%
Sharpe Ratio *	-0.56	-0.78
P/E 11F _†	11.4	8.8
EPS Growth 11F _†	12.0%	11.8%
Dividend Yield 10F _†	3.0%	3.5%

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

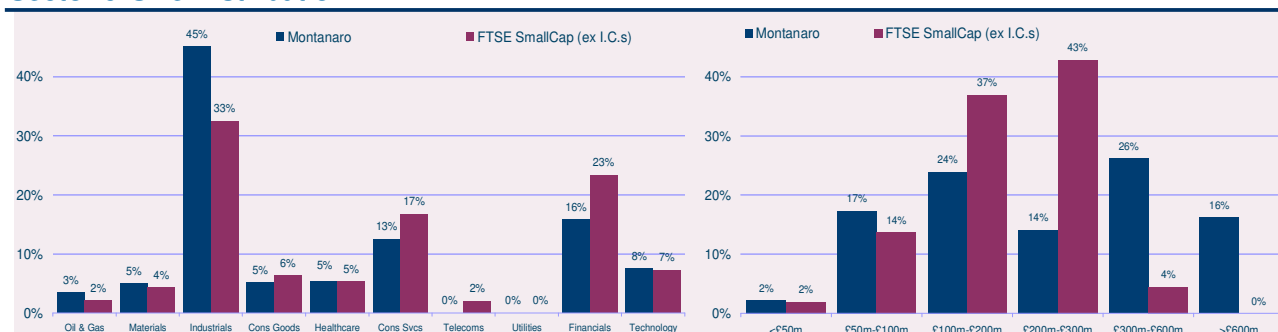
Fund Details

Launch Date	March 1995
Gross Assets	£115 million
Net Assets	£100 million
Net Gearing	13.8%
No. of holdings	64
Mgmt Fee	1% p.a.
Perf Fee	See below*
Legal Status	UK closed-end Investment Trust
Listing	London Stock Exchange
Valuation	Daily
Annual dividend	June

Top Ten Holdings

Name	Sector	% of net portfolio
1 Chloride Group	Electronic & Electricals	3.4%
2 Domino Printing	Electronic & Electricals	2.6%
3 Domino's Pizza	Travel & Leisure	2.5%
4 Dignity	General Retailers	2.4%
5 Dialight	Electronic & Electricals	2.3%
6 Victrex	Chemicals	2.2%
7 Hill & Smith	Industrial Engineering	2.1%
8 James Fisher	Industrial Transportation	2.1%
9 Senior	Aerospace & Defence	2.1%
10 Latchways	Support Services	2.1%
TOTAL		23.9%

Sector & Size Distribution



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*Performance Fee is calculated at 0.1% of each 1%, or part thereof, outperformance of FTSE SmallCap Index plus 2%, capped at 0.5%, high on high