

F&C European Small Cap ex UK Fund

One year on

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What a difference a year makes. In March 2015, equity markets were buoyant, taking their cues from further evidence of economic recovery in the European region and better-than-expected corporate earnings. Whilst the Greek debt saga continued to weigh on investors' minds, the European Central Bank, in an effort to spur economic growth and prevent a deflationary spiral, sprang into action, launching a large quantitative easing programme.

Wind the clock forward a year to the present day and Mario Draghi, the President of the European Central Bank, has just announced another round of quantitative easing, but this time within the context of deteriorating global economic news and worries about stalling growth in Europe.

It has certainly been a volatile twelve months, with European equities frequently lurching from optimism to pessimism!

Opportunities come knocking

UK investors have come to understand and appreciate the benefits of portfolio diversification both in terms of regional exposure and market capitalisation. They have long understood that opportunities for investment returns can be found beyond their borders. As a regional opportunity, Europe is a huge and diverse market, particularly within the smaller companies sector, with a plethora of high quality companies operating in an improving environment.

The *F&C European Small Cap ex UK Fund* is celebrating its first year anniversary this month. Despite the volatility over its initial year, we continued to apply our disciplined and proprietary research capabilities – the cornerstone of our investment process implemented in order to construct a portfolio of attractively-valued high quality stocks, defined as those that are run by talented and proven management teams.

A time for discipline

The year was, however, challenging with quality assets becoming increasingly expensive, and the pool of opportunities consequently diminishing. It appeared that the flood of liquidity in the region found its home in areas of the stock market that could offer certainty of earnings, irrespective of valuation. Through this influx of capital, we maintained our investment discipline, resulting in a balanced portfolio of stocks which combined both quality and value. Whilst this means the fund may have lagged marginally over this short period, we are confident that our portfolio is well positioned to achieve good returns over the medium to long term.

Market weakness offers attractive openings

The market weakness since the start of the year, unpleasant in the short term, is nevertheless welcome in that it has given us the opportunity to add a number of high quality names where we could now find that margin of safety in valuation. Examples include the Dutch-listed specialist chemical distribution company IMCD and the specialist Italian food distribution company Marr Spa. Both companies are the leaders in fragmented markets, where we would expect them to continue to take share through time, as the smaller players struggle. We have also used the market weakness to add to existing high conviction positions such as the German pharmaceutical packager Gerresheimer and Nordic-based sporting goods company Amer Sports.

Top ten holdings		
Company Name	Portfolio Weight (%)	Benchmark Weight (%)
Irish Continental Group	3.99	0.09
Gerresheimer	3.75	0.21
Origin Enterprises	3.55	0.08
Amer Sports	3.53	0.30
Cerved Information Solutions Spa	3.42	0.14
Plastic Omnium	3.38	0.00
Forbo Holding	3.37	0.19
Ctt-Correios De Portugal	3.15	0.11
Interpump Group	2.94	0.14
Rational	2.83	0.52

Source: BMO Global Asset Management, as at 29 February 2016.

The table above illustrates the level of conviction the team has in the portfolio holdings.

Long-term opportunities

We continue to believe in the long-term performance potential of European smaller companies. They offer great stock picking potential as the asset class is generally poorly understood and is not well researched. This leads to greater market inefficiencies and therefore opportunities for us to express our investment philosophy and deliver good results over the longer term.

Looking forward

The economic outlook is uncertain, but our base case scenario remains a slow economic recovery driven by improving domestic demand. In this environment, European smaller companies should benefit disproportionately as they are more domestically focused than their larger company counterparts. We look forward to continuing to manage this portfolio of exciting opportunities in a manner which we believe can deliver attractive long-term returns to our investors.

Views and opinions expressed by individual authors do not necessarily represent those of BMO Global Asset Management