



THE DRIVE YOU DEMAND

UBP | ACTIVE IN SMALL CAPS

Opportunities through selected regional exposure

**For Qualified Investors in Switzerland or Professional Investors
or Eligible Counterparties as defined by the relevant law.**

White Paper | May 2017



UNION BANCAIRE PRIVÉE

Key points

- ◆ Small and mid-cap companies often demonstrate strong growth potential, notably where they sustain high levels of innovation, which is the foundation for maintaining these higher growth rates.
- ◆ The segment tends to be less covered by the analysts' community and dedicated portfolio managers can add value by detecting hidden gems through the investment universe.
- ◆ Investing in small and mid-caps means believing in the entrepreneurial mind-set, aligning with the founding partner's drive.
- ◆ As an Active Manager, UBP has dedicated substantial resources to this segment, covering three of the largest markets.
- ◆ We believe that a well balanced portfolio should opt in a long-term allocation to the small-and-mid caps segment.
- ◆ The change in U.S. corporate tax regime would be very supportive for small and mid-caps, which tend to be more impacted than large caps
- ◆ Swiss Small & Mid Caps' international exposure and high CFROIs offer a quality investment opportunity, globally.

The global picture for equities has been rather positive so far this year, with equity markets benefitting from accelerated earnings growth. Since the beginning of 2017, with EPS growth estimates at 13% compared to 2% in 2016, global equity markets have started to show signs of a rebound.

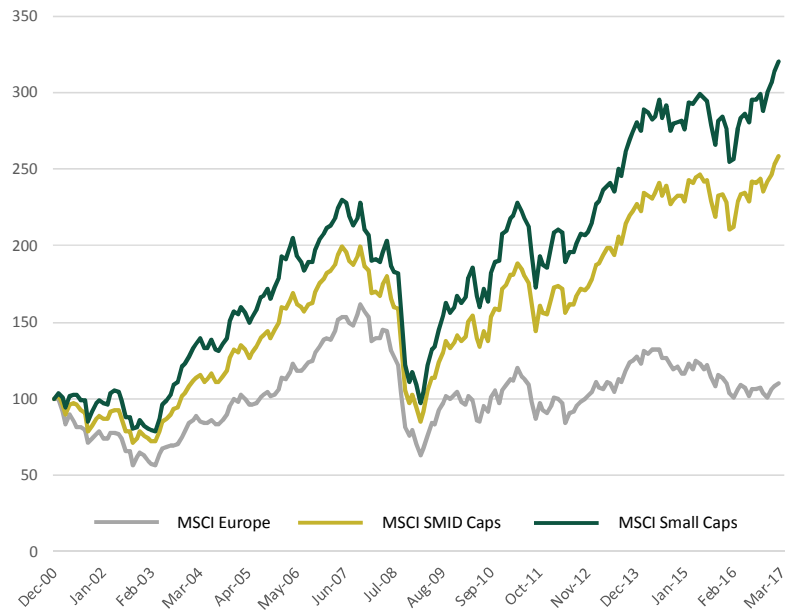
This recovery theme was supported by expectations of future investments in infrastructure and manufacturing, resulting from market anticipations of the "Trump trade".

Consequently, we have also seen positive performances in small and mid-caps, though diverging within regional markets, between the U.S., Europe and Switzerland.

We would like to highlight why small and mid-caps are an appealing investment case, how UBP has tackled this dynamic asset class and what our preferences are in this market.

Small & mid-caps specificities

Chart 1 | Historical performance: small & mid-caps vs. large caps



Source: UBP, Bloomberg Finance LP. Past performance is not a guide for current or future results.

We see compelling reasons to invest in small and mid-cap equities, as part of a well-balanced investment strategy.

- Even with higher valuations in the U.S. as in the Swiss market, due to higher earnings growth, small and mid-cap companies can demonstrate strong growth potential. When taking this potential into consideration, we believe that such valuations are currently justified.
-

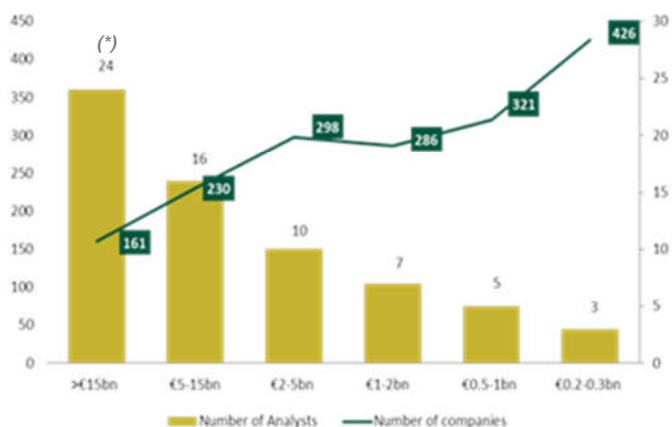
Additionally, many small and mid-caps are focused on higher levels of innovation and offer smaller base effect, relatively to large caps, hence ensuring future foundation for maintaining these higher growth rates.

- Small caps' earnings have been quite supportive as well, especially compared to last year, and they have been quicker to adjust their strategies in response to market changes.
- It is common knowledge that small cap equities tend to be less covered by the analysts' community. As only scarce broker resources are dedicated to this segment, committed portfolio managers can add value by detecting hidden gems through the investment universe.

UBP small & mid-caps capabilities

- Finally, investing in small and mid-caps believes in the benefits of an entrepreneurial mind-set, where capital remains in family hands and investments are aligned with the founding partner's drive.

Chart 2 | Average number of analysts per company covering the Europe market



Source: UBP.

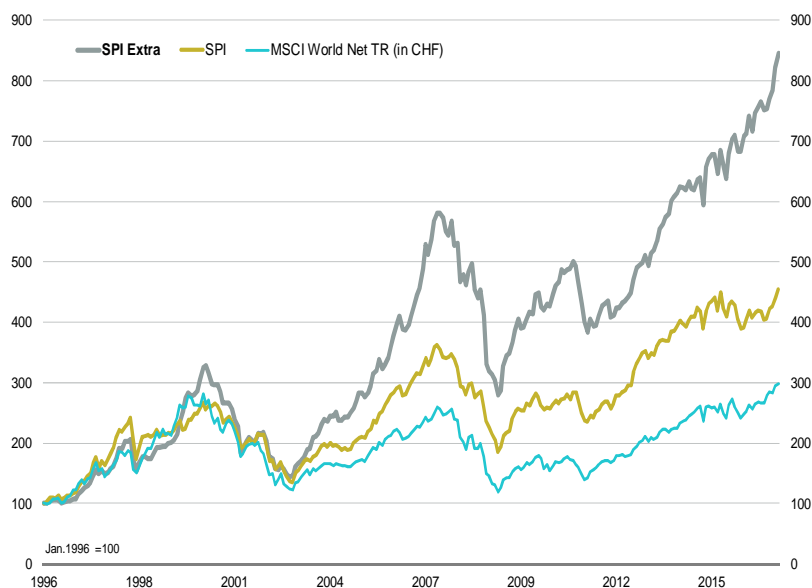
(*): refers to an average number of analysts per company

The entrepreneurial mind-set is one of main characteristics of the small and mid-cap space. It is also one of the pillars of UBP.

Additionally, this smaller market is an active manager's playing ground. It is therefore not a surprise that when dealing with small and mid-caps, UBP has decided to develop in-house capabilities, within key selected regional markets.

We started our small and mid cap business in our home market, as an emanation of our Swiss Franchise.

Chart 3 | Historical Performance Swiss Small & Mid-Caps vs. MSCI World (in CHF)



Source: UBP, Bloomberg Finance LP.

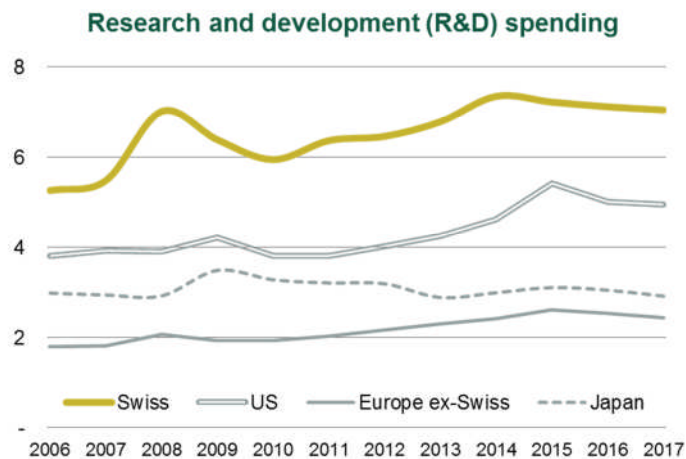
- **Swiss Small & Mid-Cap Equities**

Decades of strength in CHF, though representing a headwind, has never deterred Swiss companies of all market caps from expanding internationally. They have learnt to adapt to an ever appreciating currency.

Indeed, they managed to do so by focusing on competitive advantages and innovation, while at the same time being disciplined on costs.

As evidenced by the chart below, Swiss companies on the whole have consistently managed to demonstrate high R&D spending and a better edge to compete in their market:

Chart 4 | Swiss Companies R&D compared to other DM Countries



Source: UBP

Such behavior is reflected in the very high cash flow return on investments (CFROIs) that Swiss companies have constantly achieved over time.

After a brief respite during the financial crisis, the small and mid-cap sector regained its traditional premium to the large cap sector in recent years. This reflects expectations that this segment of the market will continue to grow earnings faster than large caps.

We have adopted a common investment philosophy:

- We invest along the whole CFROI life cycle of companies. We are building portfolios which combine high and stable CFROI companies, with more opportunistic holdings in high growth CFROI ones or attractive restructuring cases where we expect a recovery in CFROI levels.
- We further screen for valuations and momentum indicators.

As EM markets mature and start to address higher added value phases of growth, in terms of technology, automation and consumer choices, Swiss small and mid-caps have a growing role to play beyond the pure infrastructure companies. Swiss small & midcap companies offer the stability of a developed and quite uncorrelated market, with an indirect exposure to EM markets and therefore could benefit further from future growth in EM countries.

- **US Small-Cap Equities**

The U.S. economy has continued to grow steadily into Q2 2017, with a hope for manufacturing renaissance and a rebound in domestic consumption as catalysts.

Such an economic background may have a positive and long lasting impact on American companies, thus favoring the ones that derive most of their earnings from onshore activities.

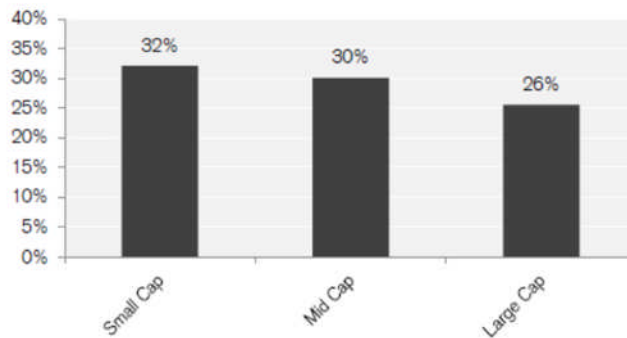
And among such companies, small caps tend to grow organically within their domestic market, thanks to the sheer size of it, hence offering more local growth opportunities.

There should be a clear change in the landscape, with a rebound in domestic consumption, higher interest rates and with the announced reforms package by President Trump. Here are some key points for U.S. small caps:

- A potential cut in the corporate tax rate to 15% should be especially helpful to small cap equities, as they currently pay incrementally more in taxes than the large cap stocks.

Chart 5 | Current effective tax rate by size index

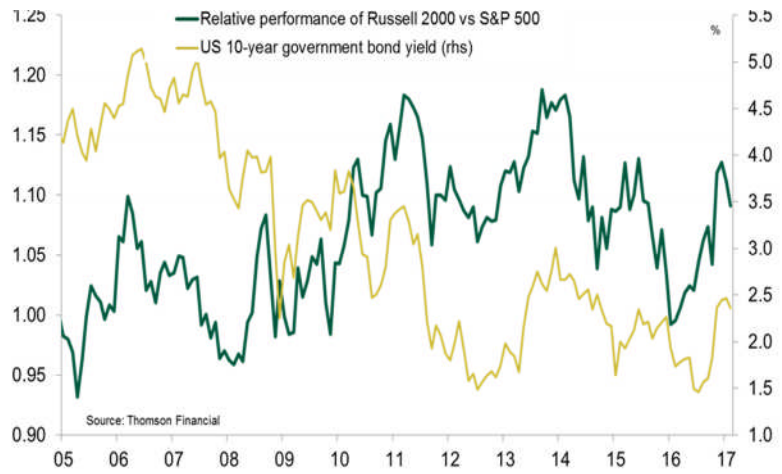
Current Effective Tax Rate By Size Index
R2000, RMid, S&P 500, Wgt Median, Ex Neg Pre Tax Income, Ex REITs



Source: CS US Equity Strategy, Russell, S&P Capital IQ/ClariFi, Compustat, as of 9/30/2016

- Less regulation would be good for small caps: President Trump has repeatedly stated he believes a strong domestic job growth will result from repealing the unnecessary regulation that has bogged down the US economy.
- Finally, given their higher sensitivity to the economic cycle, it makes sense that small caps relative performance shows a positive correlation to the U.S. 10-year yield, as shown on Chart 6. Besides, If one considers the correlation coefficient of Russell 2000 Index with the US 10-yr yield, it has been positive consistently since 2014, moving in a 0.10 to 0.55 range.

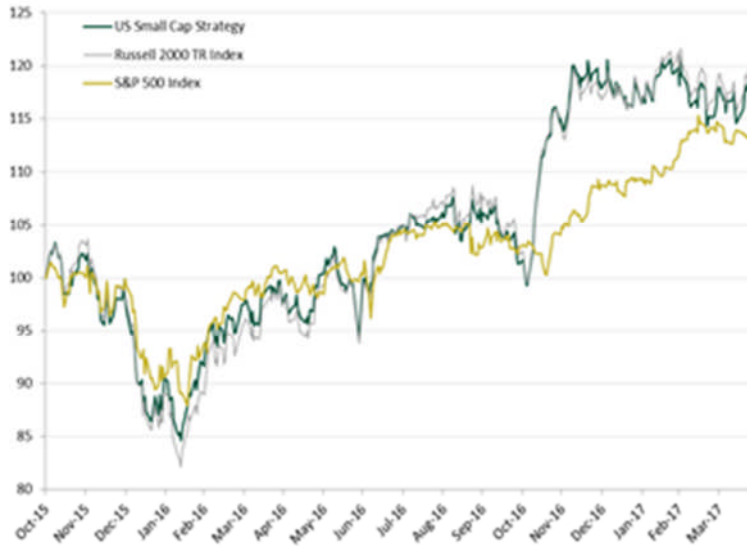
Chart 6 | Relative performance of US small caps vs large caps and long yields



Source : UBP ETR, Thomson Financial

Therefore, with the conviction that the U.S. small caps segment was still offering strong upside, UBP decided to add an investment solution and entered a partnership with an external manager.

Chart 7 | Historical Performance US Small & Mid-Caps vs. Large Caps



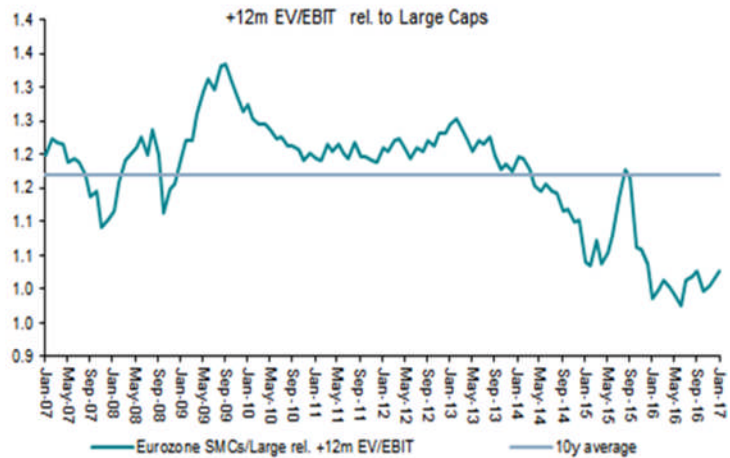
Source: UBP, Bloomberg Finance LP.

- **Europe Small & Mid-Caps Equities**

European small and mid-cap equities' recent good earnings growth, associated with valuations in line with historical average, make a strong argument for investing in the asset class.

- Indeed with minor underperformance against large caps in 2016, smaller European companies have de-rated and offer attractive valuations relative to the broader market.

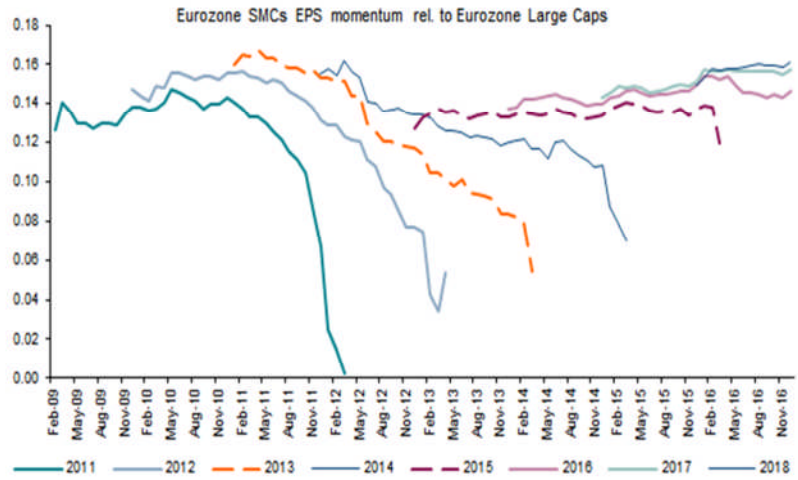
Chart 8 | +12m EV/EBIT rel. to Large Caps



Source: Factset, Exane BNP Paribas estimates.

- Such relative valuations are largely in line with their longer term history and smaller company balance sheets are in better shape with an average net debt / EBITDA of less than 1.1x. vs. 3.9x for large caps.
- And finally, solid earnings growth momentum for small caps relative to large caps, compared to previous cycles, is quite supportive.

Chart 9 | Eurozone SMCs EPS momentum rel. to Eurozone Large Caps



Source: Factset, Exane BNP Paribas estimates.

Our Europe small and mid-caps strategy and investment process is articulated around three pillars:

- We allocate capital to companies that create sustainable value, through a disciplined screening process, with a focus on cash flows.
- We apply a research process in order to identify companies with exposure to positive internal and external dynamics, in order to create value for shareholders.
- When building a portfolio, we follow a bottom-up approach, with an emphasis on conviction and risk management.

Traditionally, small and mid-caps are more exposed than large caps to cyclical segments of the market, and our investment solutions are constructed, among other things, on a flexible 60 – 40 basic rule:

- 60% of the portfolio should be dedicated to ‘sustainable returns’ companies with less volatility.
- 40% of the portfolio is exposed to companies with ‘improving returns.’

One key feature of our investment approach is the focus on cash flow return on investment – (CFROI), for a specific company. In doing so, we avoid value distortions between companies from different sectors, often due to accounting differences and net revenue allocations.

Consequently, we consider the Europe small caps space as providing our experienced portfolio manager on the asset class, with long term opportunities to outperform.

Key takeaways

- ◆ The current global economic recovery should be supportive for equity markets globally, unless systematic risk increases significantly. This backdrop is positive for small and mid-caps, making the asset class a valid investment alternative.
- ◆ UBP is dedicated to offering investment solutions, with an active management approach for different asset classes, positioned to outperform when compared to passive strategies.
- ◆ With regards to the current economic and investment cycles, small and mid-cap equities remain a building block of UBP's investment solutions.
- ◆ We believe a long term allocation to this asset class makes sense, as small and mid-cap companies often demonstrate strong growth potential, notably where they can sustain high levels of innovation.
- ◆ The segment tends to be less covered by the analysts' community and dedicated portfolio managers can add value by detecting hidden gems through the investment universe.

Benjamin Soussan

Swiss & Global – Emerging Equities - Investment Specialist
benjamin.soussan@ubp.ch

Jean-Luc Eyssautier

European Equities - Investment Specialist
jean-luc.eyssautier@ubp.com

Cédric Le Berre

External Managers - Investment Specialist
cedric.leberre@ubp.ch

Union Bancaire Privée, UBP SA

Asset Management Division

Disclaimer

This is a marketing document and is intended for informational and/or marketing purposes only. This document is confidential and is intended only for the use of the person(s) to whom it was delivered. This document may not be reproduced (in whole or in part) or delivered, given, sent or in any other way made accessible, to any other person without the prior written approval of Union Bancaire Privée, UBP SA or any entity of the UBP Group ("UBP"). This document reflects the opinion of UBP as of the date of issue.

This document is for distribution only to persons who are Qualified Investors in Switzerland or Professional Clients, Eligible Counterparties or equivalent category of investors as defined by the relevant laws (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. It is not intended for distribution, publication, or use, in whole or in part, in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it directed to any person or entity to which it would be unlawful to direct such a document. In particular, this document may not be distributed in the United States of America and/or to US Persons (including US citizens residing outside the United States of America).

This document has not been produced by UBP's financial analysts and is not to be considered as financial research. It is not subject to any guidelines on financial research and independence of financial analysis.

Reasonable efforts have been made to ensure that the content of this document is based on information and data obtained from reliable sources. However, UBP has not verified the information from third sources in this document and does not guarantee its accuracy or completeness. UBP accepts no liability whatsoever and makes no representation, warranty or undertaking, express or implied, for any information, projections or any of the opinions contained herein or for any errors, omissions or misstatements. The information contained herein is subject to change without prior notice. UBP gives no undertaking to update this document or to correct any inaccuracies in it which may become apparent.

This document may refer to the past performance of investment interests. **Past performance is not a guide to current or future results.** The value of investment interests can fall as well as rise. Any capital invested may be at risk and you may not get back some or all of your original capital. In addition, any performance data included in this document does not take into account fees and expenses charged on issuance and redemption of securities nor any taxes that may be levied. Changes in exchange rates may cause increases or decreases in your return.

All statements other than statements of historical fact in this document are "forward-looking statements". Forward-looking statements are not guarantees of future performance. The financial projections included in this document do not represent forecasts or budgets, but are purely illustrative examples based on a series of current expectations and assumptions which may not eventuate. The actual performance, results, financial condition and prospects of an investment interest may differ materially from those expressed or implied by the forward-looking statements in this document as the projected or targeted returns are inherently subject to significant economic, market and other uncertainties that may adversely affect performance. UBP disclaims any obligation to update any forward-looking statement, as a result of new information, future events or otherwise.

It should not be construed as advice or any form of recommendation to purchase or sell any security or funds. It does not replace a prospectus or any other legal documents that can be obtained free of charge from the registered office of a fund or from UBP. The opinions herein do not take into account individual investors' circumstances, objectives, or needs. Each investor must make his/her own independent decision regarding any securities or financial instruments mentioned herein and should independently determine the merits or suitability of any investment. In addition, the tax treatment of any investment in the fund(s) mentioned herein depends on each individual investor's circumstances. Investors are invited to read carefully the risk warnings and the regulations set out in the prospectus or other legal documents and are advised to seek professional advice from their financial, legal and tax advisors.

The tax treatment of any investment in the Fund depends on your individual circumstances and may be subject to change in the future.

The document neither constitutes an offer nor a solicitation to buy, subscribe for or sell any currency, funds, product or financial instrument, make any investment, or participate in any particular trading strategy in any jurisdiction where such an offer or solicitation would not be authorised, or to any person to whom it would be unlawful to make such an offer or invitation.

Telephone calls to the telephone number stated in this presentation may be recorded. When calling this number, UBP will assume that you consent to this recording.

UBP is authorised and regulated in Switzerland by the Swiss Financial Market Supervisory Authority and is authorised in the United Kingdom by the Prudential Regulation Authority. UBP is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority.

Past performance is not an indicator of future results. Any forecast or projection is indicative and is not guaranteed in any way.