Q1 2022

UBAM – BIODIVERSITY RESTORATION

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws.
Fund classification under Sustainable Financial Disclosure Regulation (SFDR): Article 9

Market Comment

- Despite the ongoing war in Ukraine, equity markets recovered from the middle of March. Investors continued to focus on movements in oil prices, which rose by around 30% in the first few days of March. Although they then fell back, Brent crude still ended the month 7% higher.
- In the US, consumer sentiment was dragged down by economic concerns but above all rapidly rising prices, despite a very solid labour market as shown by stronger-than-expected job creation figures for February. Annual inflation rose to 7.9% in February, with service prices accelerating sharply on top of rising energy costs. However, confidence levels remained high in the manufacturing sector, and even rebounded in services. As expected, the Fed raised its key interest rates by 25bp for the first time since 2018 and announced plans to start reducing the amount of assets on its balance sheet in the near future. The Fed's governors are expecting to raise rates another six times this year, confirming that taming inflation is the US central bank's main priority.
- In the eurozone, hostilities in Ukraine caused a sharp drop in consumer sentiment, which had an impact on consumer spending. Business confidence fell only slightly in both manufacturing and services, but the future activity component of the IFO index collapsed. Inflation continued to rise, as it did everywhere else, and is heading over 6%. The ECB adopted a tougher tone than expected, saying it was prepared to end asset purchases at the start of the third quarter.
- In China, tighter restrictions to combat rising Covid-19 case numbers affected PMI indices, which fell back below 50.
- Global equity markets ended the first quarter of the year in the red with -5.36% (MSCI ACWI*). In the US specifically, the S&P 500* index was down by -4.70% during the first quarter with a noticeable outperformance of the Value segment over the Growth one (-9.09% q/q for the Russell 1000 Growth* and -0.89% q/q for the Russell 1000 Value*). In this context the MSCI Europe* delivered -5.32%, outperforming the MSCI Europe Small Cap* with -9.78%. Finally, the Emerging markets delivered -6.98%, again with a high dispersion. Brazil was up +35.92% and on the other side, China was down – 14.19%.
- The IPPC (Intergovernmental Panel on Climate Change) published a report at the end of February: this is the report by the second working group (WG), which focuses on "impacts, adaptation and vulnerability" (WG I, which had a report out last summer, focuses on "the physical science basis of climate change"). "This report recognizes the interdependence of climate, ecosystems and biodiversity, and human societies and integrates knowledge more strongly across the natural, ecological, social and economic sciences than earlier IPCC assessments."

** net total return index*

Sources: UBP, Bloomberg Finance LP.

Performance Review

- During the first quarter of 2022, the UBAM Biodiversity Restoration Strategy returned -7.74% (net of fees, IC USD class), against a return of -5.36% from the MSCI All Country World Index*.

  ** net total return index*

- Considering the macroeconomic events of this quarter, the performance of the fund should be observed in two stages: interest rates and inflation, followed by geopolitical instability from the invasion of Ukraine. The year started with a continuation of the central bank regime change that was arising at the close of 2021 and already having an impact on the markets. This clear attempt by the institutions across geographies to get ahead of macro-economic trends created a difficult environment for growth-oriented investors and their companies. As such, relative performance of the fund was hampered by the Protect and Restore themes by similar levels, as both include verticals and constituents exposed to interest rate hikes and their consequences. Noticeably, the Enablers of Change vertical which includes our two sustainability focused asset managers (Impax and Australian Ethical) and other innovative growth-tilted names was responsible for the largest detraction.

- Parallel to this, continued increases in input prices combined with production issues also led to sustained widespread disruptions. Visible detractors during the first half of the quarter include Trimble (tracking and positioning solutions, sitting in Enablers of Change) and Trane Technologies (HVAC equipment manufacturer, sitting in Green Cities & Urban Spaces) who saw their margins impacted by a combination of supply chain challenges and labour availability impacting factory productivity; Hellofresh (meal-kit provider, sitting in Sustainable Management of Natural Resources) and Hain Celestial (natural and organic food company, sitting in Planet Compatible Diets) due to the rising costs and uncertainty around their ability to pass these on to customers; and Eurofins (testing services, sitting in Enablers of Change) due in part to the fading contribution of the Covid related activities. In response, the managers focused ever more closely on operational momentum and ensured that companies with higher near-term multiples were supported by strong top line, pricing power and cashflow growth.

- In the second half of the quarter, market dynamics dramatically changed as a result of the Russian invasion of Ukraine. The portfolio significantly outperformed the reference benchmark during this period (+5.55% relative outperformance in February & March combined). The portfolio benefitted from low exposure to the region and also from its geographical diversification as North American companies were seen as insulated from the risk of energy shortages and associated price increases. Similarly, companies in areas like metal recycling and farming performed strongly as their products provide alternative sources of raw materials and serve soft commodities markets. The Circular Economy vertical was particularly strong thanks to metal recyclers Sims and Befesa but the largest contributors also included AGCO (precision agriculture equipment manufacturer, sitting in Sustainable Food Production), Evoqua Water Technologies (water treatment equipment manufacturer, sitting in Planet Compatible Utilities) and Darling Ingredients (recycler of used grease and oils, sitting in Circular Economy).

- As the quarter came to a close, a number of characteristics became embedded in the short- and medium-term outlooks. Global trade patterns started adapting to a new normal, and it is recognised that geopolitics will play a bigger role in the path of stock markets in the future than in recent history. The team continued to manage the portfolio with a defensive bias, whilst maintaining an exposure to those impact industrial verticals experiencing the strongest support from this uncertain environment.

All performance figures are given net of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Portfolio activity:

- During the first half of the quarter and until the start of the Ukraine war, the portfolio managers focussed on a disciplined capital allocation approach of actively increasing exposure to solid performing companies who were meeting and beating expectations on their Q4 reporting and benefitted from better earnings visibility. These companies were mainly part of the Protect theme but belonged to a variety of verticals.

- Water related companies Badger Meter, Advanced Drainage Systems and Evoqua were increased on the back of good results, successful supply chain management and elevated product demand. In the Sustainable Management of Natural Resources, the team increased positions in DSM, Weyerhaeuser and West Fraser Timber following strong performance thanks to elevated commodity prices and positive outlooks. Similarly, infrastructure related companies Arcadis and Tetra Tech were increased progressively. These moves combined with continued reduction of the longer duration stocks due to their sensitivity to rates mitigated the impact of the market rotation on the portfolio.

- The position in Kalera was sold entirely early in the quarter as a result of its market capitalisation falling below the fund's risk parameters. Early-stage companies have been particularly vulnerable to the market's rotation against 'long-duration' stocks. The team remain convinced that vertical farming will play an important part in the reform of the food supply chain so Kalera will remain closely monitored.

- The position in Trane Technologies was also reduced significantly considering the supply chain challenges the company has experienced.

- During the second half of the quarter, building on the foundations of a good reporting season, the team favoured companies that are insulated or benefit from the evolving macroeconomic uncertainty. This was enacted by increasing the exposure to North America (Lindsay, Tetra Tech, Stantec, Deere), managing positions in higher energy consumers based in Europe (Befesa), and supporting companies which provide essential products and services to key supply chains (Waste Management, Mueller Water, American Water Works, AGCO) as they benefit from stable cash flows and less volatile performance.

- On several occasions, the team continued to take profit in successful beneficiaries when positions were reaching extended levels (Sims, Evoqua, Sipef, Nel).

- In line with these changes, three new positions were initiated during the quarter:

  GEA Group – The company makes end to end processing systems mainly used by the food manufacturing and pharmaceutical industries and therefore benefits from very strong end market momentum. GEA increases the fund's exposure to the food and agriculture supply chain while retaining end customer, geography and product category diversification.

  Deere – The company manufactures agricultural equipment with a focus on precision applications. The stock currently benefits from strong commodity prices which drive farmer's investment decisions and provides geographic and mix diversification from AGCO while adding to the attractive sustainable food production space.

  American Water Works – The company is the largest and most geographically diverse US water utility. Flattening earning growth profile for the market has led the team towards more defensive sectors including utilities which also should provide some protection against inflationary pressures.

- Finally, the portfolio activity during the quarter resulted to changes in vertical representation. Most notably, Enablers of Change decreased from 18% to 13.5% and Planet Compatible Diets decreased from 3.8% to 1.9%. On the other hand, Sustainable Food Production increased from 14% to 19%, and Circular Economy increased slightly (although offset by regular profit taking).

Outlook

The global scenario reflects moderate growth, higher inflation and tighter monetary regime:

- Global growth scenario for 2022 has been revised down under combined oil shock and lower demand. Europe looks the most exposed, while US and China are less directly impacted.
- On the positive side, one can note:
  - Resilient manufacturing sector (PMI above 50) and still positive economic surprises
  - Solid trend in labor and rising wages
  - Fiscal support still active in Europe and China
- Central banks will raise key rates further to regain control on inflation and re-anchor inflation expectations.
- Governments in Europe should take new fiscal measures to mitigate negative shocks on purchasing power and sectors.

Geopolitics will play a bigger role in the path of stock markets in the future than in recent history:

- Global trade patterns will undoubtedly adapt to a new normal. Self-sufficiency will be valued more dearly, in terms of energy, raw materials and manufacturing capability. There are some areas of the global economy which are now too concentrated to disrupt, for example, much of the semi-conductor supply chain, but other areas will experience government mandated near-shoring.
- The source and supply of commodities will be re-assessed with ‘friendly’ trading blocs grouping together for resilience and untrustworthy dominant regions becoming disrupted where possible.
- Large areas of the sustainable universe will receive an upgrade to underlying growth, for example renewable energy (self-sufficiency) and efficiency (powerful tool in the reduction of fossil fuel use).

Sources: UBP.

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