

UBAM – SWISS SMALL & MID CAP EQUITY

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws

Market Comment

- In Q3, all major equity markets posted positive returns, though with a downturn in September for most of them. The MSCI AC World finished up +8.1%. At regional level, Emerging equities were up +9.6%, US equities +8.9%, Japanese equities +5.2%, and European Equities +0.1%. As for Swiss equities, the SPI was up +2.3% and the SPI Extra ended Q3 2020 at +6.4%. YTD, the SPI and the SPI Extra have returned -0.9% and -0.7% respectively, whereas the MSCI AC World was up +1.4%.
- Economic activity continued its reopening recovery, but with fading momentum at the end of the quarter, pointing towards a still positive but slower growth pace in Q4. In the US, the manufacturing sector is in good shape with the PMI at 53.5, but in September the services sector activity declined for the first time since April from 55 to 54.6. The same happened in Europe with an increased divergence between a good momentum in the manufacturing sector and a negative sentiment in the services sector, impacted by renewed social distancing measures and constraints on hospitality.
- At the end of the quarter, the US continued to show positive earnings momentum across all sectors, whereas the picture was more mixed elsewhere. Furthermore, except for Materials, regional disparities across sectors were significant. Among the major markets, expected earnings growth rates for 2020 range from +0% for China to -39% for both the UK and eurozone, with the US roughly in the middle of the range (-16%). A sharp earnings rebound is anticipated in all major regions next year, notably for the eurozone (+55%). Regarding the major valuation metrics for global equities, the 12m forward PE fell to 19x after having exceeded 20x during the summer, the price-to-book ratio remained at 113% of its 5-year average while the 12m fwd ROE increased slightly to 90% of its longer term average.
- Switzerland's KOF indicator continued its rebound in September from 110.2 to 113.8 and now exceeds the highs seen in 2017. Unemployment continued to increase slightly over the month, but the unemployment rate remained stable. The Swiss GDP is now expected to contract by 5% this year, a drop smaller than that expected in other countries.
- Over the third quarter of 2020, all sectors apart from Financials contributed positively to the SPI Extra's performance with Healthcare, Industrials, IT and Materials adding the most. Sonova, Logitech and AMS were the most positive individual contributors, whereas Temenos, Vifor and new entrant Adecco – who lost its place in the SMI to Partners Group in the most recent index review – were the biggest detractors.

Performance Review

- UBAM - Swiss Small and Mid-Cap Equity delivered an absolute gross performance of +7.2% over the quarter, versus +6.4% for the SPI Extra. YTD, the fund accumulated +1.3% in excess return versus its benchmark. Over the quarter, stock selection added +60bps to excess returns and sector allocation +17bps. Stock selection was particularly positive in Financials and Materials, adding +82bps and +50bps respectively and the significant Healthcare overweight contributed +56bps. Stock selection in the IT and Industrials sectors detracted the most over the period with -53bps and -45bps respectively.
- The main contributors to performance over Q2 were the overweights in Tecan, Siegfried and Bachem (+61bps, +51bps and +29bps respectively). Tecan's share price rose by close to 40% over the third quarter as it is one of the main beneficiaries of the pandemic as its solutions are used in discovery and testing related to Covid-19. The increased demand for its products in the first half of the year led the company to upgrade its guidance for the full year with H1 results in August. Siegfried and Bachem – two contract manufacturers for the pharmaceutical industry – also had spectacular quarters gaining 48% and 57% respectively. Siegfried's Drug Products division achieved impressive growth rates in H1 2020 already, which is expected to accelerate into next year given the announcement of a partnership with BioNTech/Pfizer on Covid-19 vaccines mid-September. Bachem – a world leading peptide manufacturer - saw demand for propofol and other drugs to treat respiratory diseases surge in the first half of the year leading to very strong H1 results and full-year guidance above expectations.
- In Q3, the main detractors to relative performance were the overweight in Zur Rose along with the absence of exposure to AMS and Kuehne+Nagel (-61bps, -62bps and -33bps respectively). Zur Rose, whose share price nearly tripled from the beginning of the year to its peak in mid-July, sold off after H1 results in August revealed a bigger than expected loss due to continued investments. The stock ended the quarter down -15%. AMS traded up moderately over the months of July and August before it jumped by over 30% in September after Osram – where AMS has a controlling interest - had raised guidance significantly. It gained 49% over the full quarter. Kuehne+Nagel traded up 17% over the third quarter as profitability in Q2 was better than feared due to favourable air freight pricing and good cost control. The company also continued to be confident in its ability to gain market share from smaller players in the current environment.

Portfolio Activity

- Over the month of July, a new position was initiated in Comet – a previously held name – whose leadership in x-ray tubes and matchboxes for the semiconductor industry allowed it to navigate Covid-19 more or less unscathed posting a year-on-year increase in sales and profits for the first half of 2020.
- No major changes were done on the portfolio level over the month of August.
- In September, the team initiated a position in Poenina, which moved up to be the number three player in the Swiss HVAC installation industry after the integration of Caleira. This should position them well to profit from structural trends towards better energy efficiency in buildings.

Outlook

- As we head into the last quarter of the year, equity investors continue to face uncertainties around the Covid-19 pandemic and the outcome of the US elections. A re-election of Mr. Trump could increase pressure on global trade and the economy in a post-Covid recovery while deregulation and tax reductions could be a tailwind for equity markets. With a Biden win, the Trump corporate tax cut of 2017 could be at risk to be partially reversed, while we could see increased stimulus and spending on climate change mitigation as well as increased access to federally funded healthcare. A divided government could lead to gridlocks in tax and spending regulation and higher volatility would be expected for equity markets.
- The expected earnings decline this year (-10%) and recovery next year (+17%) are a lot more benign for Swiss equities than any other major equity market implying lower risk of downgrades to the 2021 estimates. In addition, while the Swiss market has significantly outperformed global markets during the peak of the Covid-crisis, it has slightly underperformed since lockdowns have started to ease. The Swiss SMID segment has similarly outperformed several regional markets during the crisis and has done better than the Swiss large caps since economies have started to reopen. This demonstrates again how crisis-resistant the smaller Swiss companies are due to their innovation power which has often made them mission-critical to their large global customers cementing leading market positions in niche industries. Combined with efficient cost structures to deal with the strong CHF as well as conservatively financed balance sheets we continue to see the Swiss SMID segment well-positioned to outperform global equity markets over the cycle.

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