UBAM – SWISS SMALL AND MID-CAP EQUITY

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws.
The classification of the fund(s) as per the Sustainable Finance Disclosure Regulation (SFDR) is available on ubp.com or in the latest prospectus.

Market Comment

- Despite the volatility brought by the banking sector fallouts over the month of March, major equity markets still delivered positive performances over the first quarter of the year. The MSCI AC World finished Q1 up +7.3%, with European equities gaining +8.6%, US equities +7.5%, Japanese equities +7.1%, Swiss equities +5.9% and Emerging Market equities +3.9%. The SPI Extra also delivered strong results over the period with +10%, benefiting from its exposure to recovering Industrials and IT sectors, rather than to pressured banking names Credit Suisse and UBS.
- Major central banks maintained their tightening stance announcing rate hikes during the month, confirming their confidence in the resilience of the banking sector. The Fed raised key rates by 25bps on the back of modest growth, high inflation and ongoing job gains. The ECB also raised rates by 50bps citing inflation concerns. Interestingly, despite less pressure to combat inflation in Switzerland, which currently stands below 3%, the SNB chose to lift rates by a further 50bps in March. This underlined the strength of the economy, as the hike was initiated the same week as Switzerland saw one of its two systemic banks be taken over. The global earnings momentum continued to deteriorate with 2023E EPS growth reaching 0.2% for global equities at the end of March as the recent tension in the banking system increased the odds of a recession in the coming quarters. The 12m forward PE ratio for the MSCI AC World traded around 15.2x, below its long-term average at the end of the quarter. The US Manufacturing PMI came in slightly higher in March at 49.2 vs 47.3, with sentiment increasing on production and employment.
- For Swiss equities, the earnings picture remained resilient with 14.4% expected for 2023, and a stable 11.5% for 2024. Swiss equities traded at 17.9x forward PE ratio, close to pre-pandemic levels. The KOF leading indicator slightly decreased from 98.9 to 98.2 at the end of March, reflecting the financial stress and the global uncertainties. Trade balance also came in lower at 3.3bn CHF vs 4.9bn for the prior month, driven by lower exports as well as lower imports. The Swiss Manufacturing PMI dropped over March down to 47 from 48.9 for the previous print, notably on weakening sentiment on backlog of orders, inventories and prices. The yearly inflation rate in Switzerland fell nevertheless to 2.9% in March from 3.4% in February with yearly core inflation also slowing to 2.2% from 2.4%. This was driven by lower energy and lower core good prices.
- Over the month of March, the Industrials and Consumer Staples sectors were the biggest contributors to the SPI Extra's performance, while on the other hand, Real Estate and Communication Services were the largest detractors. In terms of individual names, Straumann and Kuehne + Nagel were the best contributors, whereas Roche bearer shares and Idorsia were the bottom detractors.

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

Performance Review

- UBAM – Swiss Small and Mid Cap Equity delivered +11.2% in gross performance in Q1 2023 versus +10% for the SPI Extra. Over the quarter, both stock selection and sector allocation were positive contributors to relative performance (+60bps and +61bps respectively). The selection effect in the Healthcare sector along with the underweight in Real Estate were top performance contributors over the period.
- Over Q1, the biggest contributors to performance were the absence of exposure to SGS, the underweight in Roche bearer shares as well as the overweight in Swissquote (+58bps, +57bps, +37bps respectively). SGS lost -2.8% over the period after the company reported an increase in sales adjusted for acquisitions and currency effects, with losses nevertheless in operating results and associated margins driven by higher costs. Roche bearer shares dropped -20.7% over the quarter after a member of Roche's owning families sold 2.5% of bearer shares at a discount in February. The name continued to face pressure from a subdued outlook for 2023 with lower expected sales and profits driven by the Covid-19 overhang, along with its CEO change in March. Swissquote gained +33.6% over the quarter benefiting from a couple of analyst upgrades after the company had preannounced 2022 results in line with guidance and remained confident about its mid- to long-term outlook.
- The main performance detractors over the quarter were the overweight in Huber + Suhner as well as the underweight in Julius Baer and Swatch (-30bps, -27bps and -27bps respectively). Huber + Suhner lost -6.8% over Q1 despite reporting results in line with expectations and increasing proposed dividend. The company however refrained from disclosing a sales forecast given the uncertainties and low visibility. Julius Baer gained +15.7% in Q1 as analysts predicted the Swiss bank would benefit from clients diversifying away from the UBS-Credit Suisse merger. The name also reported solid results for 2022 amidst a challenging environment. Swatch was up +19.2% after it announced strong sales expectations for 2023 and an increase in dividends during its Investor Day.

Portfolio Activity and ESG

- Over the first quarter of the year, the team sold its remaining position in Autoneum after disappointing results, and exited the position in U-Blox following a change of CEO which could imply a risk of reset of expectations. The position in Vontobel was also sold following disappointing results on continued difficulties in AM. The position was replaced by Julius Baer, where the team sees good operational and market momentum. A new position in Flughafen Zurich was added on continued travel recovery post Covid and the expected return of transit passengers from Asia into Europe and stable economic development in Switzerland supporting both travel and real estate / commercial activities. The team initiated a new position in Swatch Group. The Consumer is proving to be more resilient than expected in view of continued full employment. In this context, it is possible that the optimism that the Chinese Consumer, post pandemic, will return to luxury investment is not entirely misplaced, especially if the post pandemic consumption witnessed in the West is emulated in China. A new position in Ypsomed was introduced to the portfolio, a leading developer and manufacturer of injection and infusion systems while the position in VP Bank was exited following the stock recovery at the beginning of the year.

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- At the end of March 2023, UBAM – Swiss Small and Mid-Cap Equity had a AAA ESG rating and an ESG Quality Score of 9.21 (based on MSCI ESG Research ratings), compared to a AAA rating and 9.10 score for the SPI Extra. The fund delivers a lower weighted average carbon intensity than its benchmark with 27.0 tons of CO_2 emissions /$m sales vs 36.8 for the SPI Extra. The Swiss Small and Mid-Cap Equity portfolio also follows a strict exclusion policy. It does also not hold any position identified as being in violation of international standards by both data providers MSCI ESG Manager and Sustainalytics.

Outlook

- Despite some volatility and headwinds during the first quarter of the year as well as a further downgrades to the global earnings picture, global equities have gained +7.3% in performance with a resilient +6% for Swiss equities (+10% for the SPI Extra) pulling through the banking sector setbacks. Looking into the second quarter of the year, the team would expect companies to execute well on their existing order books under more favourable conditions: supply chains have eased, transport costs and energy costs started falling, and wage cost inflation seems to be generally covered by price increases of goods and services. Investors should also start to look toward 2024 earnings as we move through the year, past the contained Bank fallouts, and through the earnings results, where an attractive >10% EPS growth and reasonable valuations still provide attractive investment opportunities.

- In this environment, Swiss equities are well positioned with a resilient earnings picture, notably with a high-quality and growing small and mid-cap space. UBAM – Swiss Small and Mid-Cap Equity continues to focus on small and mid-cap Swiss companies with visible earnings trajectory which are expected to deliver strong performances as the market looks towards 2024 earnings and GDP growth momentum.

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