
# UBAM - SWISS SMALL & MID CAP EQUITY

Quarterly Comment | Q3 2019

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

*Market Comment*

- September marked the end of a mixed quarter for equity markets with the MSCI AC World finishing Q3 2019 flat at -0.03%. Major indices delivered positive performances over the quarter except emerging markets which were down -4.3%. Japanese and European equities posted the biggest gains with 3.3% and +2.6%, most of which recorded over the month of September, followed by Swiss equities with +2.1%, US equities +1.7%. The SPI Extra also posted gains with +1% over the quarter. Year to date, Swiss equities continue to outperform with +24.4% versus close to +16% for global equities.
- In September, major central banks steered further easing measures following a second setback in equity markets that came in August after that of May. Major economies progressed into late cycle stages with a synchronized deceleration in industrial production and stabilising inflation in labor and commodities markets. The US Federal Reserve cut interest rates by a 25bps in mid-September for the second time in 2019, leaving the door open for another cut if needed before the end of the year. This came after the ECB also cut its key interest rate to -0.5% with plans to restart in quantitative easing in November. September was notably marked by a sector/style rotation into oversold value names that proved to be short lived, as it was not supported by EPS growth expectations. In fact, cyclical sectors, commodity related and financials, posted the biggest negative earnings revisions for 2019. Despite the convergence of 2019 earnings growth expectations for global equities to low single digit (2% for 2019 versus 10% for 2020), valuation levels remained around their long term averages. With a 3% dividend yield, global equities could still deliver 5% of total return for 2019 on unchanged multiples.
- Early September, despite a strong Swiss Franc, the Swiss National Bank kept rates unchanged at -0.75% while reiterating its willingness to intervene in the FX market as necessary. Swiss GDP expectations for the year 2019 have been lowered by the SNB to a 1%-1.5% range; inflation was also revised lower from 0.6% to 0.4% for the year. Trade balance came in weaker for the end of August as trade war worries and a strong currency pressured Swiss exports. The unemployment rate for Switzerland remained low and stable at 2.3% at end of August, with inflation flat at 0%. PMI prints rebounded to 47.2 at end of August on improved business sentiment vs. 44.7 in July, but dipped down to 44.7 for end of September. The KOF leading indicator fell however by 2.3 points to 93.2, highlighting weaker industrial production despite a resilient consumer confidence.
- Over the third quarter of 2019, the SPI Extra saw a slight reversal of performance in some cyclical sectors such as Consumer Discretionary and Industrials. The Real Estate sector was on the other hand one of the top contributors to performance, along with Financials and Health Care.

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.

## *Performance Review*

- The fund returned -0.08% over the quarter, versus +0.99% for the SPI Extra. Year to date, the fund delivered +24.1% with more than +2.9% in gross excess return. While sector allocation was flat over Q3, stock selection was rather negative with -1% contribution to the fund's relative return. This was mainly driven by some names in the Industrials sector which lost close to -3% over Q3, while its underweight in the fund contributed to +24bps. Stock selection was positive in sectors like Financials and Health Care on the other hand with +55bps and +29bps respectively.
- The main contributors to performance over the third quarter of the year were Financials and Health Care names such as Cembra, Helvetia and Siegfried (+24bps, +18bps and +16bps respectively). Cembra was up close to +10.5% over the quarter after the market reacted positively to synergies potential expected from its cashgate acquisition. Helvetia's share price was up more than +12% at the end of Q3 after the insurance provider reported a 29% increase of net profits for H1 2019. This came as a result of recovering capital markets, strong investment and underwriting results and positive tax effects. Siegfried also returned positive share price performance with +15% after posting solid H1 results with 5.8% sales growth and confirming its 2019 guidance for solid mid-single digit growth.
- The main detractors to relative performance over the quarter were the absence of exposure to Swiss Prime (-31bps) and the overweights in Emmi and Forbo (-27bps and -24bps respectively). Swiss Prime's share price rose +14.5% over the quarter after the real estate company reported H1 results that exceeded expectations. This was helped by the reversal of deferred tax of around 160mn CHF following the tax cut in Geneva as well as a market optimism surrounding its planned sale of the retirement housing group Tertianum. Emmi on the other hand struggled over the quarter with a -10.8% drop in share price after it reported lower than expected H1 operating profits but still confirmed its full year earnings target amid a competitive environment. Forbo's share price also lost -14% at the end of the quarter despite reporting solid H1 results with positive EBIT margin growth. Some disappointment came however on the sales level, particularly in the flooring systems division reflecting challenging construction markets in various countries.

## *Portfolio Activity*

- During the month of July, the team decided to take some profits on its position in Logitech, after a strong YTD performance and raising concerns about the gaming industry to which Logitech is considered to be highly dependent.
- Over the month of August, the team took advantage of short term price weakness in order to reinforce its position in Stadler based on a continued good momentum of order wins. The name is currently trading at close to 25% premium to its IPO price.
- No major changes were done on the portfolio level during the month of September.

*Outlook*

- After a flat third quarter, the team expects equity markets to continue moving sideways for the rest of the year, with volatility swings coupled with geopolitical developments as trade remains a major topic. Despite downside risks on the political front and trade developments, consumer confidence is still resilient on stable inflation and labor conditions. An active management approach could offer equity investors a diversified exposure to proven high quality and growth names without the need to time style factors in this late cycle phase. Furthermore, as the Swiss market does not have any direct exposure to Energy and Metals & Mining stocks where the 2020 earnings' rebound is at risk, Swiss equities still offer one of the highest and most stable earnings growth (around 8% for 2019 and 9.6% for 2020). Coupled with 3% dividend yield, Swiss equities should still deliver 11% total return for 2019 on unchanged multiples. Valuations on both the SPI and the SPI Extra have recovered and are trading around their long term levels (17x for the SPI and 21x for the SPI Extra).

## Disclaimer