

UBAM - SWISS EQUITY

Quarterly Comment

Marketing Communication

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

- The last quarter of the year pushed global equity markets higher with another rally and +11% gains for the MSCI AC World. US equities rose +11.2% in Q4, Emerging Market equities +7.9%, European equities +6.4%, Japanese equities +2.9% and Swiss equities +1.4% (performances in local currencies). Over the full year 2023, the MSCI AC World delivered +22.2% with most regional markets finishing the year in the green despite a limited market breadth and elevated bond yields. The SPI Extra outperformed the larger SPI at the end of 2023, with +6.5% and +6.1% in performance respectively.
- As expected by the market, the Fed announced no change in its key rate policy in December, mentioning the pressure of financial conditions on global activity and alluding to potential interest rate cuts in 2024. The US GDP growth projection for 2024 was revised slightly down from 1.5% to 1.4%, whereas Q3 2023 growth came in strong at 4.9%, lower than the 5.2% expected, but higher than the 2.1% for the prior print, reducing hard-landing fears. The yearly trend in US headline inflation marginally declined from 3.2% to 3.1% as core inflation remained stable at 4.0% yoy. The ECB also held its key rates unchanged as Eurozone inflation gradually eased to 2.4% yoy, slightly above the 2% target. 2024 earnings growth expectations for global equities remained stable at 10%, coupled with 16.6x forward PE ratio. This growth expectation reflects a broad recovery in corporate earnings in all major markets, which will probably, at least partly, depend on inflation and interest rates trajectories.
- The SNB once again left key rates stable at 1.75%, citing easing inflationary pressure despite persisting economic uncertainties. The Swiss Manufacturing PMI rose slightly to 43.0 in December, which is still suggesting contraction. The KOF indicator also turned higher to 97.8 vs 97.2 for the prior month, with a slight improvement in business confidence at the end of the year. The unemployment rate for Switzerland was unchanged at 2.1%, while inflation continued to ease to 1.4% at the end of November. 2024 earnings growth expectations for Switzerland still stand at 9.2%, supported by the projected recovery in the healthcare, financials, and materials sectors.
- Over Q4, Industrials, Financials and Materials were the largest contributing sectors to the SPI's performance, while Consumer Staples, Healthcare and Communication Services were the largest detractors. In terms of individual names, UBS, ABB and Sika were the top performance contributors over the quarter, while Nestlé, Novartis and Lonza were the largest detractors.

Performance Review

- Over Q4 2023, UBAM - Swiss Equity delivered +3.4% in gross performance, versus +1.4% for the SPI. Sector allocation, notably the overweight in Industrials and underweight in Consumer Staples, as well as stock selection in Healthcare and Industrials were the major performance contributors over the quarter. The fund ended the full year with +1.1% gross excess return achieved with +7.2% in gross absolute performance vs +6.1% for the SPI.
- During Q4, the biggest contributors to relative performance were the underweights in Nestlé and Novartis as well as the overweight in ABB (+72bps, +30bps and +24bps respectively). Nestlé lost -6% over the quarter as the global consumer sector continued to suffer from the potential longer term impact of weight loss drugs on calorie consumption. Nestlé also reported results and FY guidance below expectations due to supply constraints in their US vitamins business. The company however also highlighted that their Nestlé Health Science business could be a beneficiary of weight loss drugs, as it can help address malnutrition, loss of muscle mass, and other undesired side effects of the drugs with its products. Novartis dropped -4.6% despite reporting good results and raising its outlook for the third time. The Sandoz spin-off, which is aimed at transitioning Novartis into a pure-play in innovative medicines, triggered nevertheless some market concern over potential pressure on Novartis' pipeline and sales. ABB gained +13.7% after the company reported a solid set of results, with strong order backlog and sales growth, as well as a raised full year guidance.
- The main detractors to relative performance over the period were the overweight in Pierer Mobility, the absence of exposure to Holcim, as well as the overweight in Lonza (-26bps, -23bps and -22bps respectively). Pierer Mobility lost -26.6% after the company expected challenging economic conditions to persist into 2024, where consolidation and cost reduction plans are expected to secure the group's profitability. Holcim was up +12.3% on the back of good third quarter results that revealed broad growth drivers supporting profitability. The company raised its full year guidance with a 17% EBIT margin target. Lonza's share price came under pressure over Q4, dropping -16.9%. The company's CMD in October confirmed a new mid-term guidance for 2024-2028, but nevertheless anticipated a muted 2024. In fact, 2024 is expected to be stable compared to 2023, instead of showing a step-up, mainly due to some positive effects being shifted from 2024 into 2023 related to pandemic arrangements, together with the potential risk from the Kodiak business which faced negative read-out in its phase III. The investment team's medium to long term conviction remains intact for Lonza with a pick up in results expected in 2025 and onwards, notably sourced from visible commercialised products.

Portfolio Activity and ESG

- Over Q4, the team decided to exit its underweight position in Richemont given the continued pressure on hard luxury names that has not eased during this reporting season. The position in Julius Baer was reduced to a neutral benchmark weight, on the back of short-term pressure to their CFROI® profile expected to come from one-off loan loss provisions. The proceeds were reinvested in existing positions in Straumann, Arysza and Partners Group. Over the month of October, the portfolio received shares in Sandoz, the global leader in generics and biosimilars, following its spin-off from Novartis. The team moved to increase this position subsequently.



Q4 2023

- At the end of December 2023, the portfolio had an ESG Quality Score of 7.6, with a AA rating versus 7.5 for the SPI and a AA rating (based on MSCI ESG Research ratings). The Swiss Equity portfolio follows a strict exclusion policy. It does not hold any position identified as being in violation of international standards by both data providers MSCI ESG Manager and Sustainalytics. The portfolio has a weighted average carbon intensity that is 71% lower than its benchmark, with 23.5 tons of CO2/\$m sales vs 83.2 tons of CO2/\$m sales for the SPI.

Outlook

- Global equity markets finished 2023 on a strong positive note, despite some signs of growth slowing, the banking sector fallouts, wars in the Middle East and Ukraine, and still elevated bond yields. US and European equities have regained all of their 2022 drawdown and are trading close to their respective end-2021 market highs. Investors have factored in a soft-landing scenario for the US with possible interest rate cuts going into 2024. Moreover, with the Covid overhang now largely reflected in corporate results and the normalization of interest rates and inflation levels in sight, this should provide a supportive environment for equities in 2024, and more specifically for longer duration assets: quality companies with strong future cash flow streams. As valuation levels currently trade around long-term averages, earnings growth is expected to be the main market driver for 2024, after a low base of 0% growth in 2023.
- In Switzerland, the expected recovery in GDP growth from 0.8% to 1.5% in 2024 could be a tailwind for Swiss equities, especially in the quality small and mid-cap segment. Swiss equities, which offer similar EPS growth prospects to US equities at relatively lower valuation level (9.2% for Swiss equities vs 10.8% for US equities for 2024e EPS growth, and 17.2x vs 20x 12m fwd PE ratio respectively), could serve as a diversified and fundamentally driven performance source in 2024. There is potential for the Swiss market to catch up on absolute and relative performance in 2024, capitalizing on stabilizing activity in the healthcare sector and calmer waters for its banking industry, along with a strong Swiss Franc acting as a safe haven in periods of political and macro-economic uncertainties.
- In this context, UBP's Swiss Equity strategy, with its focus on sustainable value creation and visible earnings growth, as well as its attractive exposure to quality small and mid-cap names, should be well positioned to capture diversified performance opportunities in 2024.

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