THE DRIVE YOU DEMAND

UBAM - SWISS 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 equities 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 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 down to -0.5% with plans to restart 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 saw a sharp reversal of performance in cyclical sectors with Consumer Discretionary, Industrials and Materials losing -7.7% -1.3% and -1.8% respectively (-35bps; -16bps and -11bps of respective contribution to the SPI). Defensive sectors on the other hand continued performing strongly with Consumer Staples contributing to +1.64% to the overall performance of the index, and Nestlé alone contributing to +1.62%. Financials and Healthcare were also positive performers with +0.6% and +0.3% in respective contribution to the overall performance.

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

- Over the third quarter of 2019, the fund returned +2.2% in gross performance versus +2.1% for the SPI. Year to date, the fund has accumulated close to +26.1% in gross performance with +1.6% in excess return. Stock selection contributed positively over the quarter with +26bps, which was slightly offset by sector allocation with -19bps. Consumer Staples was in fact the most detracting sector with -77bps, mainly due to the forced underweight of Nestlé in the fund. Stock selection in the Financials and Health Care sectors contributed the most over the quarter with +40bps, +22bps respectively.
- In terms of individual names, the best contributors on the portfolio level over Q3 2019 were the underweight in Novartis which lost -3% over the quarter (+38ps contribution), the absence of exposure to Richemont which lost close to -10% (+34bps) and the overweight in Zurich Insurance Group (+21bps). Despite publishing a strong set of Q2 results and a positive guidance for the full year, Novartis share price struggled to keep up with the overall market following the FDA's accusation of manipulation of test data for the approval of the gene therapy Zolgensma. Richemont's share price faltered over the quarter as Swiss watch exports dropped more than 10% on concerns ensuing from protests paralyzing Hong Kong, a key luxury market. Zurich Insurance's share price increased by more than 12% over Q3 as it reported a strong 16% increase in operating income for the first half of the year, and looked set to meet its targets for its three-year program focused on cost savings.
- The biggest relative detractors over Q3 were the forced underweight in Nestlé, which was up 7% (-62bps) as well as Roche (up 5%, -15bps), and the overweight in Sika (-35bps). Nestlé continued its rally with more than 39% return YTD, especially after beating consensus estimates with 3.9% reported organic sales growth for Q2. The company also improved its profitability, on track for its 2020 targets and confirmed its outlook for the full year. September put a halt to this rally as the name corrected down by almost 2.5%. Roche reported the EU Commission's approval on the Tecentriq combination therapy for the treatment of breast cancer, and further confirmed its ability to maintain growth through patents with new products representing 20% of sales. Sika on the other hand had a weak performance over the quarter with -12% drop in share price after reporting modest Q2 organic growth results offset by positive M&A impact. The team still holds a positive view on the name as new countries and Emerging Markets penetration still offer positive prospects for organic growth.

Portfolio Activity

- During the month of July, the position in SGS was exited and the proceeds were reinvested in the existing position in Alcon. On the back of a weak performance since Q1 19 coupled with high valuation and on-going earnings downgrades, the team decided to cut the exposure to the industrial company. The position in Alcon was reinforced as the name is showing resilience to the economic and political backdrop. A position in Interoll was initiated following the publication of their 1H19 results. The expected slowdown in the second half of 2019 is not seen as an issue by the team based on the company's record year last year and the resilience of long term fundamentals.
- During the month of August, the team took some profits in Partners Group after solid YTD performance, and reinforced its position in Vifor after strong reported results and positive guidance with good growth momentum.
- No major changes were done on the portfolio level during the month of September.

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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 should 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.

Disclaimer