THE DRIVE YOU DEMAND

UBAM - GLOBAL EQUITY SUSTAINABLE GROWTH

Quarterly Comment | Q2 2019

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

Market Comment

- After a strong start of the second quarter, equity markets faltered over the month of May before rallying again over the month of June. Over the second quarter of the year, Swiss equities were leading major equity markets in terms of performance, gaining more than 6.5% over the quarter. US equities followed after gaining +4.3%, European equities were also up 3% while Emerging Markets lagged with +0.6% in performance. Year-to-date, Swiss Equities also led the performance pack with a performance of 21.8% performance versus +17.0% for the MSCI AC World.
- Earnings growth expectation for global equities continued to be revised slightly down to around 4%, while growth expectations for Swiss equities remain close to 8% for 2019. US equities mainly maintained positive earnings momentum except for cyclical sectors. Earnings revisions for Europe however were negative as well as for Japan and Emerging Markets. Global equities valuation stood at 15.1x at the end of June, still below the long term average of 15.7x. Swiss equities traded around their long term average, at 17.3x forward PE ratio at the end of June.
- Volatility returned to the market in May with the VIX index spiking above 20 over the month as trade war fears reignited. Manufacturing PMI signals weakened globally in tandem with moderate inflation, leading to accommodative stances from the ECB and the Fed. The World Bank reduced its global growth forecast from 2.9% for 2019 to 2.6%. Growth remains positive however globally, driven by consumers and the service sector. A trade war escalation or its prolongation could present a tail risk to the global growth momentum which could require more stimulus from Central Banks to protect domestic demand and employment dynamics.
- All sectors of the MSCI AC World ended Q2 2019 in positive territory except for the Energy sector; with Financials and Information Technology as the biggest contributors to performance. The picture was mixed over the month of May however, with all sectors in red namely cyclical sectors such as Information Technology, Financials and Consumer Discretionary. The second half of 2019 could witness a return of such rotations towards more defensive and quality sectors in times of increased uncertainty.

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

- UBAM - Global Equity Sustainable Growth returned 7.3% in gross performance at the end of the second quarter of 2019, with an excess return of 3.7% over the MSCI AC World. Year to date, the fund is now up 23.7% with 7.5% in excess gross return.
- Stock selection was the main driver of relative performance over the quarter with close to 4% contribution. Selection in the IT and Industrials sectors contributed with 1.8% and 1.3%, respectively, whereas selection in the Energy and Communication Services was slightly negative with -39bps and -32bps, respectively.
- In terms of individual names, the exposure to SolerEdge Technology and the overweights in Total System Service and Wirecard, all in the Information Technology sector, were the best contributors to relative performance (+91bps, +48bps and +37bps). SolarEdge share price rose close to 66% over the quarter as investors continue to see big market share opportunity for the solar equipment market in terms of market share, especially with better US residential numbers. TSS (Total System Services) share price rallied after Global Payments announced plans to acquire the company in all-stock deal worth 21.5bn USD. Wirecard returned close to 35% over the quarter recovering most of its first quarter weakness, after beating estimates and reporting strong results across the board.
- The biggest detractors over the period were the exposure to Stoneco, the overweight in OMV and Occidental Petroleum. Stoneco share price struggled after the company announced a new follow on issue of 19.5mn shares, also due to the fears that the Brazilian Bank Itau Unibanco said it will shorten the holding period before merchants gain access to their payment proceeds. The company still generated better than expected results over the first quarter and still exudes strong growth prospects. OMV and Occidental struggled in line with the Energy sector following US and Iranian tensions over the recent past. Both companies maintain solid investment cases with Occidental winning the Anadarko bid and OMV reporting improving and strong Q1 results.

Portfolio Activity

- During the month of April, the team decided to exit from Constellation Brands after successive weak quarter results. The position in Goldman Sachs was also exited after lackluster earnings revisions and share price momentum and was replaced by a new position in Morgan Stanley which proved to be well positioned in Wealth Management with a better mix of revenues and cost control. A new position was also initiated in Schneider Electric, with high and stable CFROI and fading raw materials headwinds. New positions were also initiated in Prudential Financial and Axa Equitable benefitting from better equity markets and attractive valuations. Zebra Technologies was also added at the end of the month, a data capture company expected to maintain CFROI levels around 35%.
- Over the month of June, the team decided to exit from Cognizant after weak results with a reduced growth and outlook. The team also sold its position in E*Trade Financial Corporation on limited benefits from lackluster short term US rates and risks of competitive pricing. New positions were initiated in Enel, with 75% of earning coming from renewables and networks, Linde, and Air Liquide from the Praxair merger leading to better industry pricing.

Outlook

- The second half of the year will test the recovery scenario with FX headwinds and slowing growth signals. Considering China's slowdown along with the faltering PMI momentum in the US, both leading economies are expected to take steps to avoid new tariff headwinds. Global markets seem to have priced in the growth slowdown and a return of accommodative monetary policies while valuations are in line to slightly below their long-time averages.

- This increased downside risk environment requires a cautious positioning for equity investors facing foggy financial markets. Despite the short set back in May, equity markets have rallied close to 16.2% since the beginning of the year. In the late stages of the cycle, quality names offer downside protection as they target high and stable earnings with low leverage. The portfolio has been positioned accordingly as mentioned in previous reports, toward high and stable CFROI names.

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