

UBAM - SWISS EQUITY

Quarterly Comment

Marketing Communication

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

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Market Comment

- Over Q2 2023, global equity markets delivered strong results with the MSCI AC World up +6.2%. Japanese equities gained +14.2%, US equities +8.3%, Emerging Market equities +2.3%, Swiss Equities +2.2% and European equities +0.9%. The SPI Extra was flat at -0.01%, bringing its YTD performance to +10.0%, versus +8.2% for the SPI and +13.9% for the MSCI AC World.
- In June, inflation figures remained resilient which led central banks to keep a hawkish stance. In the US, while the yearly headline inflation trend was down from +4.9% to +4.0%, core inflation only decreased moderately from +5.5% to +5.3% y/y and the 2023 outlook for core PCE was revised up from +3.6% to +3.9%. Key rates did not change but Chairman Powell mentioned potential further hikes in the coming months – though at a slower pace. In the Eurozone, the outlook on inflation was revised up for the next 3 years, especially for core inflation from +4.6% to +5.1% for 2023. Key rates increased by +25bps as expected and the ECB mentioned that rates should be brought to sufficiently restrictive levels to meet the 2% inflation target indicating further hikes. Business sentiment weakened further with the US Manufacturing PMI decreasing from 48.4 in May to 46.3 in June. The Eurozone Manufacturing PMI also declined from 44.8 to 43.6. Over the quarter, EPS growth projections for global equities remained steady at 0% for 2023 and declined slightly to around 10% for 2024. Global equities' 12m forward PE increased to 16.2x, just above the long-term average but with big differences across sectors and regions. US equities are now trading at an all-time high premium versus global equities after the re-rating of growth stocks and mega caps.
- In Switzerland, the SNB increased its policy rate by +25bps to +1.75%. Given increasing inflationary pressure forecasted for the medium-term, Chairman Jordan noted that rates would "most likely" need to be raised further. For June, the CPI figures came in slightly lower than expected with +1.7% vs +1.8% expected y/y and +0.1% vs +0.2% expected m/m. The unemployment rate slightly increased from 1.9% to 2.0%, but remains at a low level. Business confidence decreased in June as seen in other countries, with the KOF indicator deteriorating from 91.4 to 90.8, vs 89.0 expected. The decline is mainly due to lower foreign demand, while indicators for the manufacturing and construction sectors were slightly positive. Earnings growth expectations are now standing at +9.5% for both 2023 and 2024 for the MSCI Switzerland.
- In Q2, the defensive Healthcare sector as well as Industrials and Materials were the largest contributors to the SPI's performance, while Consumer Staples was the largest detractor. In terms of individual names, Novartis and Roche were the best contributors, whereas Nestlé and UBS were the largest detractors, the latter remaining under pressure from the merger announcement.

Performance Review

- UBAM - Swiss Equity delivered +0.4% in gross performance over Q2 2023, versus +2.2% for the SPI. Stock selection detracted to relative performance (-2.2%), particularly in the Healthcare and Industrials sectors. Sector allocation contributed positively (+0.4%), especially the underweight in Consumer Staples and the overweight in Industrials. YTD, the fund is up +7.8% vs +8.2% for the SPI.
- During Q2, the biggest contributors to relative performance were the overweight in Alcon, the underweight in Nestlé and the overweight in ABB (+25bps, +24bps and +17bps respectively). After a volatile start to the year, Alcon was up +14.9% in the second quarter, jumping on the results report, which triggered EPS upgrades. Alcon raised its constant currency growth guidance to 7-9% from 6-8% prior, and now expects EPS near the high end of the \$2.55-\$2.65 guide range, while consensus had \$2.59. The underweight in Nestlé contributed positively as the stock reversed the stronger performance during March and April and lost -1% in Q2. Despite a positive earnings report during the quarter, EPS estimates were downgraded on reduced expected impact from product pricing going forward, while volumes are still running negative. The CFO is stepping down after 8 years at the company. ABB gained +12.1% during the quarter after it saw large estimate increases after reporting results, driven by 22% organic growth (vs 15% expected) and almost double the margin improvement with +200bps y/y vs expectations of +100bps. The company introduced a >10% organic revenue growth guidance, accelerating from slower growth last year.
- The main detractors to relative performance over the period were the underweight in Novartis as well as the overweights in Tecan and Bachem (-25bps, -20bps and -16bps respectively). Novartis was up +7.4% in Q2 as the company outlined an ambitious growth strategy at the Capital Markets Day for its generics division Sandoz, which is due to be listed shortly. Good momentum in sales of existing products as well as strong margins in Q1 led the company to increase both revenue and profit guidance for 2023. Tecan lost -13.4% during the quarter. The company reports half-yearly but faced some negative EPS revisions influenced by profit warnings and read-across from distant peers. As the company has low exposure to biotechs, weakness in H1 should be more driven by seasonality and FX rates and allow for re-acceleration in H2. As a peptide maker for the pharmaceutical industry, Bachem was facing EPS downgrades similar to other healthcare tools' names, influenced by profit warnings and read-across from distant peers, and was down -14% in Q2. The stock reacted negatively to a newspaper interview, where the CEO talked about 2023 and 2024 risking to be challenging due to ongoing major expansion projects. We think these projects will finally support the growth of the company.

Portfolio Activity and ESG

- In Q2, the team initiated a position in SFS Group following a meeting in early May as the company was reassuring on business trends. Something admittedly well reflected in the recent strong share price performance. However, the company demonstrates a stable 10% CFROI® (Cash Flow Return on Investment. Source: Credit Suisse HOLT) and could be an attractive higher quality name to have exposure to this year. A position in Ypsomed - leading developer and manufacturer of injection and infusion systems for self-medication and a renowned diabetes specialist - was also initiated given its strong growth potential.



On the other hand, the position in PSP Swiss Property was sold on the back of a less optimistic outlook for Swiss real estate. Over the quarter, the position in Richemont, which was among the biggest performance detractors during the first quarter and in 2022, has been gradually increased to limit the tracking error. The current expectation is to leave the position as an underweight as a risk mitigation exercise, in view of the current outlook on China. Valuation of the company also continues to cause the team some concern. The position in Partners Group was reduced ahead of H1 results given concerns on AUM gathering.

- At the end of June 2023, the portfolio had an ESG Quality Score of 7.6, with a AA rating versus 7.8 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 67% lower than its benchmark, with 27.1 tons of CO2/\$m sales vs 81.3 tons of CO2/\$m sales for the SPI.

Outlook

- The current context of slowing producer and consumer sentiment has put pressure on global corporate earnings for 2023 and while GDP forecasts are pointing to a growth recovery later in 2023 and for 2024, manufacturing PMIs are weakening, leading to some uncertainties for the remainder of the year. Within this context, Swiss Equities are well positioned, benefiting from an advantageous macroeconomic positioning (low unemployment, resilient GDP growth picture, contained inflation and interest rates), supporting a resilient and stable earnings outlook.
- The Swiss Equity Strategy should benefit from the active selection of value creative companies with strong fundamentals across different market segments and industries, notably within the quality Swiss small and mid-cap space where still resilient Swiss GDP growth is expected to be supportive.

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