Q4 2020

UBAM – EUROPE SMALL CAP EQUITY

Quarterly Comment

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

Market Comment

- Following the regional disparities observed in Q3, the fourth and final quarter of 2020 displays more homogenous developments, in terms of both performance and Covid19 evolution. Combined with a busy political agenda made up of unfolding US elections, the finalisation of Brexit negotiations, and widespread continuation of monetary and recovery stimulus, this was an eventful ending to the year.

- On one hand, the pandemic took a turn for the worse as autumn materialised and winter approached, with rapidly rising infection rates in Europe and the US surpassing the previous highs. As the capacity of intensive care units filled up, governments were forced to implement new lockdowns with the hope of slowing down the spread of the virus. This temporarily supported continued outperformance of pandemic winners such as online retail and healthcare.

- Nonetheless, pharmaceutical companies announced early November that they had been successful at developing vaccines which effectively reduce Covid19 symptoms by helping individuals build antibodies prior to getting infected. This caused a sharp change of momentum on the equity markets in favour of value sectors such as hotels, airlines, energy and traditional retail which had their best quarter since 2009, rising nearly 16%. Although underperforming for the quarter, their growth counterparts still rose by 13%, allowing them to maintain a significant lead for the year overall (34.2% versus -0.4%).

- Overall, equities were up in all regions during the quarter. The UK FTSE All-Share is the leading index with +12.6% return, followed by the US S&P500 returning 12.2% and the MSCI Europe ex-UK index displaying 10.2% returns. The MSCI Europe Small Cap index rose by 16.6% during the quarter. This is not representative of the full year numbers which reflect the regional disparities a lot more: +18.4% for the US S&P500, +2.1% for the MSCI Europe ex-UK and -9.8% for the UK FTSE All-Share. European Smaller companies outperformed their large cap counterparts during 2020 with a return of 4.6% from the MSCI Europe Small Cap Index.

- The US growth stocks which had been important contributors to the country's performance throughout the year were affected by the vaccine news but following a peak of uncertainty the market found comfort in the election results and the prospect of a less confrontational president allowed a strong Q4. Good news also came from the UK a few days before the end of the year, as a Brexit deal was finally agreed with the EU which supported a +5% appreciation of the GBP.

- On the emerging markets side, strong performance this quarter again due to hopes of increased global trade and a cyclical recovery. This was fueled by high demand for medical supplies and technological equipment which boosted Chinese activity, leading to +20% returns of the MSCI EM index (and 18.7% for the full year).

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.

- Credit markets display marginally stronger performance than the previous quarter, but it must be noted that this is stimulated by central bank intervention. On the corporate side the US high yield rallied by +6.5% during the quarter, followed by Euro high yield which was up +5.6%. More broadly, the Global Investment Grade instruments returned +4.3% during the period, Euro Government bonds returned +1.2%, followed by UK Gilts +0.6% and US Treasuries down -0.8%.

- Overall, the positive performance across the board makes Q4 feels like a better quarter than would have been anticipated 3 months ago. The vaccine news is undoubtedly positive and gives a sense of light at the end of the tunnel, but it must not be ignored that it will take time for countries to roll it out and that the current restrictions will have an economic impact for the first couple quarters of 2021.

- All indices are total return in local currency, except global ones in US Dollars.

Performance Review

- During the fourth quarter, UBAM Europe Small Cap Equity returned 21.2%, outperforming the MSCI Europe Small Cap Index which returned 16.2%. Since the start of the year, UBAM Europe Small Cap Equity returned 15.30%, outperforming the index by +10.72%.

- Stock selection was the primary driver of relative performance during the final quarter of the year, with notable outperformance from our holdings of industrials and communication services companies. Within industrials, our holdings of clean technology companies and environmental solutions providers strongly outperformed. These included recently added solar equipment company Soltec Power Holdings SA, solar park operator Solarpack Corporation Technologia SA, fuel cell development company Ceres Power, engineering company Arcadis, industrial recycling company Befesa SA, and ventilation systems supplier Volution Group. Soltec and Solarpack benefited from strong operational momentum and increasing investor interest in the renewable energy supply chain. Ceres Power Holdings PLC rose on the back of very positive newsflow from its key manufacturing partners driving further confidence in its royalty-based business model. Arcadis reported very strong third quarter results with particularly strong cashflow, and also announced a new strategy update for the years 2021-2023 with updated topline growth, margin and working capital targets. Befesa benefited from ongoing progress in the execution of its industrial plan in China, as well as a strong improvement in the zinc price over recent months. And finally, Volution Group PLC reacted positively to a strong trading update for the opening months of its fiscal year, highlighting very strong topline and margin development. Volution Group has also benefited following the announcement of its new sustainability strategy in September and the issuance of a credit facility which is linked to the successful execution of this plan. Within communication services, our holding of Codemasters Group Holdings PLC performed very strongly on the back of an attractive all cash takeover offer from the leading video gaming company EA Games. This followed an initial offer from Take Two Interactive that undervalued the company's strong racing game franchise and growth prospects. Elsewhere, a number of our holdings of consumer-oriented companies such as travel retailer WH Smith PLC, hotel company Dalata Hotel Group PLC, and luxury clothing company Moncler SpA, benefited on the back of the positive Covid vaccine announcements and subsequent hopes for a gradual normalisation in travel patterns.

- A number of less economically sensitive companies detracted from relative returns during the fourth quarter as they lagged the broader market rally. These included distribution company DCC PLC, property company Deutsche Industrie REIT and video gaming company Stillfront Group. Our holdings of pharmaceutical packaging company Gerresheimer AG suffered after they announced higher capex than anticipated for 2021 and 2022. We believe this will contribute to higher growth rates going forward and management have very clearly outlined the ongoing operational excellence and growth programmes which should be supportive for the share price. Building materials company Kingspan Group also suffered on the back of its handling of the Grenfell tower inquiry and subsequent management changes.

Portfolio Activity

- During Q4 2020, we initiated new holdings in solar equipment manufacturer Soltec, and in public transport operator National Express Group PLC.
  - Soltec is one of the leading global manufacturers of solar tracking systems, which enable solar installations to track the sun more effectively and thereby improve their output. The company has a very strong industrial backlog and pipeline, and a rapidly developing project business. We felt that the valuation on offer at the IPO for this well run and rapidly growing business was very attractive compared to peers.
  - National Express is a leading public transport operator focused primarily on private and municipal bus services in Europe and the US. The company has a very strong operational track record and stands to benefit in the mid to long term from a solid contract pipeline in municipal and commercial transport, as well as a strong outsourcing trend in US school bus. In the shorter term, we believe the company stands to benefit strongly from a recovery in the use of public transport and coach services as vaccination programmes are rolled out and domestic travel patterns normalise.
- Elsewhere in the portfolio we decided to increase our exposure to attractively valued quality names that should be more exposed to an improving consumer and macroeconomic situation during the course of 2021, assuming a successful rollout of Covid vaccination programmes. These included travel retail company WH Smith, online ticketing company CTS Eventim AG, pub company JD Wetherspoon PLC, central London property company Shaftesbury PLC, visualisation technology company Barco NV, testing company Applus Services SA, and industrial holding company D'Ieteren SA. We also decided to top up our holding of Gerresheimer AG at attractive levels following their recent capital markets day. Finally, we added to holdings of Volution Group PLC, as we believe the group stands to benefit strong from increasing sector regulation and the valuation remains extremely attractive.
- During the final quarter of the year, we exited two holdings namely oil and gas company Cairn and building materials company Kingspan Group PLC. Cairn Homes PLC had performed strongly in recent months on the back of a rising oil price and hopes for a positive settlement from an ongoing Indian tax arbitration case, and we have preferred to invest in clean energy and related technology companies on the portfolio as we believe these will offer superior longer term growth opportunities for investors. Kingspan has been a very successful holding on the portfolio for a number of years and has seen a significant valuation rerating. Furthermore, we see much better value in Volution which will benefit from similar trends in more stringent building regulations over the longer term.

- In addition to the sales mentioned above, we trimmed our holdings of a number of stocks that have performed extremely strongly during the course of 2020 in order to manage their position sizes and to take advantage of opportunities elsewhere in the portfolio. These included video gaming companies Codemasters and Stillfront, healthcare companies DiaSorin SpA and Virbac SA, online financial services company Avanza Bank Holding, swimming pool supplies business Fluidra SA and industrial heat engineer Spirax-Sarco Engineering PLC.

Outlook

- The exceptionally strong recovery seen from smaller companies in the second half of the year puts the asset class firmly ahead of large cap European indices for the full year 2020. Part of the explanation for this outperformance can be gleaned from the polarisation in returns experienced within European equity markets and the sectoral composition of the smaller companies universe, which has a higher exposure to more innovative and disruptive companies in sectors such as technology, healthcare equipment, engineering, clean tech, communication services, and online retail. But it is also worth keeping in mind that smaller companies have traditionally provided attractive relative returns to investors following periods of market disruption and we believe that they will continue to attract attention in 2021.

- Despite the obvious challenges presented by the ongoing Coronavirus pandemic, we remain convinced about a number of longer-term secular growth trends that are often disproportionately represented by companies in the small and mid-cap universe. Whilst the increasing polarisation between growth and value segments of the market and ongoing equity market volatility are making markets particularly difficult to navigate, they can also provide interesting valuation entry points in out of favour quality companies with sustainable business models for investors prepared to take a mid to long term approach.

- Against a continued challenging backdrop, we maintain a well-balanced portfolio from a country, sector and market capitalization perspective, with a slightly higher exposure to consumer and industrial sectors into the new year compared to earlier in the year. We believe that effective stock picking will remain crucial to investment returns in 2021, and our focus on sustainable business models – strongly financed, well managed, competitively advantaged companies with strong or improving returns and secular growth drivers in their end markets - should continue to stand the fund in good stead.

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