

UBAM – SWISS SMALL & MID CAP EQUITY

Quarterly Comment

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

Market Comment

- In Q4, all major equity markets posted strong positive returns. The MSCI AC World finished up +14.7%. At regional level, emerging equities were up +19.7%, US equities +12.1%, Japanese equities +11.2%, and European equities +10.8%. As for Swiss equities, the SPI was up +4.7% and the SPI Extra ended Q4 2020 at +8.9%. In 2020, the SPI and the SPI Extra have returned +3.8% and +8.1% respectively, whereas the MSCI AC World was up +16.3%.
- In anticipation of an economic recovery in 2021, global equities achieved positive returns despite the second wave of the pandemic and the successive announcements of renewed restrictions across Europe and the United States. The positive news flow around successful Covid-19 vaccine trials led to a cyclical recovery benefiting sectors that had been severely hit by the pandemic. The results of the US election as well as the announced extensions of supporting policy measures in the US and in Europe further fueled market performance.
- 12-month forward earnings estimates were upgraded in all major regions over the last month of the year, with the earnings revisions ratio turning slightly positive everywhere. At the global level, earnings momentum remained the strongest for the cyclical sectors, in particular materials, consumer discretionary and financials. Among the major markets, 2021 EPS growth rate estimates range from +16% for Switzerland to +48% for the eurozone, with the US towards the low-end of the range (+20%) and emerging markets in the middle (+34%), though with sharp disparities between countries. The major valuation metrics for global equities moved up over the quarter. Global equities' 12m forward PE edged up to 19.9x, only marginally lower than back in August, the price-to-book ratio rose to 2.4x – its highest level since 2007 – and the 12m fwd ROE continued to move higher, too.
- In Switzerland, business sentiment decreased over the quarter. However, after having been revised down for two consecutive months, both KOF and PMI indicators unexpectedly improved in December, pointing towards firmer activity. At the end of the quarter, GDP growth forecasts for 2021 have been revised down to +3% (from +3.8% back in October) given the renewed deterioration in the economic situation as a result of the second wave of the pandemic. While the average inflation rate for 2020 remained in negative territory at -0.7%, the Swiss State Secretariat for Economic Affairs (SECO) revised its 2021 inflation expectation slightly upwards to +0.1% (from -0.1% back in October).
- Over the third quarter of 2020, all sectors contributed positively to the SPI Extra's performance with Industrials, Financials and Information Technology adding the most. In terms of single names, the best contributors were Julius Baer, Logitech and Adecco, while Schindler, Relief Therapeutics and AMS detracted the most.

Performance Review

- UBAM - Swiss Small and Mid-Cap Equity delivered an absolute gross performance of +9.3% over the quarter, versus +8.9% for the SPI Extra. In 2020, the fund accumulated +1.8% in excess return versus its benchmark. Over the quarter, stock selection added +93bps to excess returns while sector allocation detracted -54bps. Stock selection was particularly positive in Materials and Industrials, adding +95bps and +38bps respectively. As for sector allocation the overweight in Healthcare and underexposure to Industrials detracted -48bps and -26bps respectively.
- The main contributors to performance over Q4 were the overweights in Partners Group and Dottikon ES (+71bps and +45bps respectively), as well as the absence of exposure to Schindler (+50bps). Dottikon ES was up +60.0% over the quarter as the company posted very strong half-year results and its shareholders approved a stock split as well as a potential capital increase to finance capacity extensions at an EGM in early December. Partners Group was up +22.7% in Q4, as the good performance of financial markets clearly benefited their AUMs and performance fee outlook. Schindler was down -4.8% in Q4, as the Swiss elevator manufacturer continues to face several headwinds into 2021, like pricing pressure in new installations, raw material price increases and negative impact from the significant appreciation of the CHF.
- In Q4, the main detractors to relative performance were the absence from Julius Baer and Dufry (-74bps and -46bps respectively) as well as the overweight in Tecan (-36bps). The Swiss bank and the global travel retailer benefited from the rotation into cyclicals driven mainly by the vaccine news and the prospects of a reopening of the economy. Over the quarter, their share prices were up +32.1% and +95.0% respectively. Tecan, a laboratory equipment company that clearly benefited from the pandemic over the year, was down -5.5% in Q4. Like other “lockdown winners” the stock came under pressure with the vaccine news in early November and a strong guidance upgrade for 2020 could only partially compensate that down move.

Portfolio Activity

- No major changes were done on the portfolio level over the month of October.
- In November a position was initiated in Vontobel on the company's good Q3 results. Vontobel enjoyed strong net new money growth in both its Wealth and Asset Management divisions and managed to convert these newly gained assets into profitable investment products. Another position was built in VP Bank after a good meeting with the company's management highlighting the importance of their intermediary business and its potentially positive impact on their private banking business. In order to finance these two new positions in the financial sector the remaining position in Swiss Life was sold as the company had been off benchmark for some time. Finally, a position was initiated in SFS Group given its improved outlook for 2020 and 2021, notably in automotive.
- In December, the team took advantage of weakness in the share price of AMS AG to build a new position in the name. While there are continued worries that AMS could lose some of its Apple business, they are the first mover in combining illumination and sensing technologies which could open new addressable markets for them leveraging on Osram's existing relationships with major automotive OEMs and tier 1 suppliers. On the other hand, the position in Barry Callebaut was exited given the continued difficult environment and low visibility for their high-margin Gourmet business.

- Over the quarter, the position in Partners Group was reduced given its entry into the Swiss large cap index SMI.

Outlook

- Our base case for global equities remains an expected market return of around 10% in 2021, driven by substantial EPS growth from 2020's depressed levels but some multiple reversion towards longer-term averages from currently rather elevated levels. We are looking for a slow return to normal life, but the path back to growth could be quite diverse regionally, depending on the persistence of the second wave of Covid-19 infections and concurrent confinement measures by governments.
- We tend to focus on the value creation potential of different industries and individual companies rather than sector allocation, as value creation is a primary driver of long-term equity performance. In the current environment we favor stocks that continue to be supported by long-term structural trends while they should also benefit from the global growth recovery expected next year.

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