THE DRIVE YOU DEMAND

UBAM - SWISS SMALL & MID CAP EQUITY

Quarterly Comment | Q1 2019

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

Market Comment

- The SPI Extra ended Q1 2019 up nearly 13% recovering most of the negative Q4 2018 performance. The small and mid-cap performance was largely in line with the larger SPI index which was up 14.4% since the start of the year. Likewise, global equities rallied close to 12% over Q1 2019. The quarter finished on a strong note despite cautious news with mixed macroeconomic data and more dovish central banks worldwide.

- The US Fed and the ECB announced keeping rates on hold for the rest of the year. This pushed the yield on 3-month treasuries to rise above the rate on 10-years for the first time since 2007. The German 10-year bond yields dropped below 0% for the first time in over two years after its manufacturing PMI fell to 44.7, the lowest since 2012. The Swiss National Bank likewise kept interest rates unchanged at -0.75% and cut its inflation forecast again on global growth slowdown. The KOF Leading Indicator recovered to 97.4 at the end of March sending a signal of stabilising business sentiment in Switzerland. While earnings expectations worldwide were revised down further, 2019 earnings growth expectations for the SPI continue to be at mid-single digit level (6-8%) with potentially higher figures for the SPI Extra (8-10%).

- Swiss GDP growth for Q4 2018 came in positive at 0.2% vs. -0.3% in Q3 2018. This was driven mostly by a modest rebound in consumption and exports. Some weakness was recorded on the inventories, investment and construction side. This came as a sign of caution about the loss of momentum in the global economic outlook. Moderate growth is still expected for Q1 with full year GDP growth expected to slow to a range of 1.3-1.6% in 2019.

- March was marked by a sector rotation with strong performance from defensives. All sectors in the SPI were positive YTD except Communication Services and Utilities with Health Care being the strongest sector. This came despite some earnings downgrades especially among Financials and Consumer Discretionary names. Swiss equities multiples have expanded over Q1 2019 after a sharp compression in Q4 last year. The forward PE ratio increased from 18.2x to 20.8x for the SPI Extra over Q1 2019 compared to a PE ratio of 16.7x for the SPI at the end of March versus 14.7x at the end of 2018.

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

- The fund returned +16% over the quarter, outperforming the SPI Extra which was up +12.9% by +3.1%. All sectors contributed positively with allocation and selection adding +1.6% and +1.5% respectively to performance in Q1 19. Strong stock selection in the Industrials and Financials sectors (+79bps and +71bps respectively), along with a positive allocation from the Communication Services and Information Technology sectors (+47bps and +41bps) were among the top contributors. Slightly negative selection came from the IT and Healthcare sectors (-9bps and -7bps respectively).
- The main contributors to performance over the quarter were the overweight in Straumann (+47bps), the absence of exposure to Sunrise (+38bps) and the overweight in Emmi (+31bps). Straumann, which suffered from a general rotation from growth into value names towards the end of last year, reported solid year end results. Organic growth for Q4 2018 was at 21.6% compared to consensus at 16.8% and all regions contributed positively. Once again a clear demonstration of the resiliency of its business model as it has successfully managed to capture market share setting the tone for positive 2019 guidance. The stock price was up 32% over the quarter. Sunrise which was down 15% over Q1 19reported Q4 results in line with estimates; however the company guided for higher capex and announced the acquisition of the cable operator UPC in an aim to reinforce its position against its main competitor Swisscom. This deal, planned to be all cash funded by a 4.3bn CHF rights issue, raised some market concerns on the expected amount and mix of cost and revenue synergies. Emmi reported higher than expected H2 2018 operating results along with organic growth of 2.3%, the highest since 2014, mainly driven by high-margin categories in the US. The stock was up 28.5% over the quarter.
- The main detractors to relative performance over the quarter were Schaffner (-24bps), Feintool (-21bps) and Crealogix (-20bps). Schaffner was down close to 10% over Q1 after the company aligned its expectations for 2019 with the current economic environment, projecting a decrease in net sales mainly in its automotive division. Feintool reported good FY18 results but a slightly negative outlook for sales due to falling volumes in automotive. The stock price was down 10% over the quarter. Crealogix was down 5% after it reported a net loss of CHF 1.4mn for their first half 2018/2019 results and management now only guiding for a second half EBITDA in line or slightly above the first half given uncertainties regarding sales mix and the impact of Brexit on their UK subsidiary.

Portfolio Activity

- In February 2019, the position in Bossard was closed as the team became more sceptical about volume demand from key US customers, Deere and Tesla.
- In March, the position in SFS was exited across the whole Swiss equity franchise as the team believes that the slower growth in some of their end markets could put pressure on operating leverage and continued high capex will put a lid on FCF generation. The team reduced the position in Zur Rose after the 2018 results came in below expectations and 2019 is shaping up to be a transition year for the company. The team profited from a share placement in Huber + Suhner to build a position in the name as the structural growth outlook for the company has turned more favourable given its exposure to 5G wireless network rollouts and e-vehicles.

Outlook

- Concerns over a marked slowdown in GDP growth – especially in Europe –, Brexit and rhetoric of the US and China regarding trade, continue to dominate the macroeconomic environment. Swiss companies only have 3% of their revenues exposed to the UK (1% only for Swiss small and mid-caps) and are therefore not expected to be seriously affected by a disorderly Brexit. A potential return to a global "Goldilocks" economy marked by moderate but steady GDP growth and low inflation allowing a market-friendly monetary policy, has historically proven to be a favorable environment for equity investments. Due to the superior value creation profile of Swiss companies as reflected in the high average CFROI level of around 7.5% vs. the global average of 6% over the past five years, we would expect the Swiss equity market do well in such a scenario.
- Over the shorter term however the team is concerned that the recovery rally from the December lows has over-extended itself and would not be surprised to see a modest correction in the second quarter of the year. The positioning of the portfolio has been adapted accordingly to reflect a more cautious and defensive short- to mid-term view.

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