Q4 2022

UBAM – EUROPE RESPONSIBLE SMALL CAP EQUITY

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws.
Fund classification under Sustainable Financial Disclosure Regulation (SFDR): Article 8

Market Comment

- Equities posted strong returns over Q4, with the MSCI World* returning 9.76% in USD terms. The MSCI Europe* returned 9.55%, while the MSCI Europe Small Cap* outperformed with 10.92%. The MSCI EM* was up 9.70% and the S&P 500* as a US proxy was up 7.42%. The overall performance was driven by signs of abating inflation, a general ease off the tightening pedal, helping build optimism that the recession might not be as deep as initially feared, and a weaker US dollar.

- 2022 was a very difficult year for markets and highly unusual in the sense that it was only the third time in the past century that major equity and bond indices produced negative returns in the same calendar year. In contrast to 2021 which was fuelled by extraordinary levels of monetary stimulus the year started with a clear commitment from the Fed to address inflationary pressures by raising rates and setting out a plan to withdraw quantitative support. Subsequently we have seen a fast pace of rate hikes in the US which has been followed by central banks globally, including by the ECB.

- Inflation has proven to be very 'sticky' rather than transient as many had hoped and we ended the year with a clear expectation of further rate rises and quantitative tightening to come despite weaker economic growth becoming apparent. Markets have also been absorbing elevated geopolitical risks after the shocking invasion of Ukraine which has created huge volatility in energy, agriculture, and commodity markets. The supply side issues that came to light during the covid pandemic continued to cause shortages and disruption not least because of China's self-imposed measures as it continued to attempt to contain the spread of infections.

- Unsurprisingly the tightening of monetary conditions has had the greatest negative impact on the assets that had become most inflated by the previous unprecedented level of stimulus and the bull market leaders became the bear market laggards – notably technology, pre profit growth stocks and cryptocurrencies.

- It is natural to expect the corporate sector to suffer as economies experience recessionary conditions, but earnings have been remarkably resilient so far given the strength of macro headwinds. It is notable how many companies have proven adept at passing on higher costs to consumers particularly those with strong brands and hence good pricing power. Dollar strength was also a major feature of the year and for many European companies operating globally this provided a strong tailwind for earnings when translated back to Euro's.

** net total return index*

Sources: UBP, Bloomberg Finance LP

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.

- The worst performing areas in Europe, aside from technology, were those exposed to interest rate sensitivities such as consumer stocks and property while rising energy costs were problematic for industrials. Unsurprisingly the best performing sector was energy, while defensives such as telecoms and healthcare also produced resilient returns. Financials, and Banks in particular, witnessed a two-way pull as prospects for earnings improved on the back of rising rates while fears of recession and bad debts kept enthusiasm in check. Consequently, the sector has seen some volatility with mixed share price performance overall.

Performance Review

- During the fourth quarter of the year, UBAM Europe Responsible Small Cap Equity returned 5.12%** compared to a return of 10.92% from the MSCI Europe Small Cap Equity index*. For the full year 2022, the fund declined by 28.99%, compared to a return of -22.50% from the index.
- During the final quarter of the year, the fund struggled to keep pace with index gains, impacted by its quality growth bias against a market driven more by the value style, and an underweight exposure to financials, a sector which performed strongly on signs of potentially peaking inflation. Stock selection across a number of sectors, including industrials, healthcare, and communication services also detracted from relative returns during the final quarter of the year. Negative contributors from these sectors included Teleperformance, Sanoma, and Alk Abello.
- Teleperformance (call centre operator) suffered on market concerns about working conditions of content moderation employees following various press articles on the subject. Sanoma (education and media) fell on the back of a disappointing third quarter earnings report which highlighted challenges in the Dutch education distribution business as well as a deterioration in the outlook for Finnish media. Alk Abello underperformed on the back of a weaker than expected outlook for tablet sales for the full year resulting from a less active pollen season in Europe.
- On the flip side, positive contributions came from our holdings of D'Ieteren (holding company), CTS Eventim (online ticketing) and Mersen (electrical power and advanced materials). D'Ieteren made gains on expectations of continued strong operational progress at its most important holding, the services company Belron. Also, a new CEO - Carlos Britto (formerly CEO of AB Inbev) - was aappointed as successor to Gary Lubner who had been CEO since the year 2000. CTS Eventim reported very strong third quarter results, benefiting from a continued normalisation in the attendance of live music events. Finally, Mersen also reported strong third quarter results, benefiting in particular from strength in the advanced materials division.

** net total return index   ** Class IC, EUR net of fees*

Sources: UBP, Bloomberg Finance LP.

Portfolio Activity

- During the quarter we initiated new positions in **SES Imagotag** (retail tecnology) and **Bucher Industries** (industrial machinery). SES Imagotag is a French retail technology company, global leader in smart digital labels and related IoT solutions, a segment which is growing strongly. The advanced instore supermarket signage, monitoring and optimisation they enable for retailers makes it a play on food waste reduction (which is quantified at 30% of all food produced globally) and energy efficiency while getting exposure to the IT sector. Bucher Industries is a Swiss industrial machinery business with particular expertise in agricultural equipment. They stand to benefit from strong farm incomes due to high agricultural commodity prices, and a fleet age that is above historical averages.

- Amongst our existing holdings we increased our exposure to companies which are making strong operational progress that is yet to be fully reflected in the company valuation. These included **CTS Eventim** (online ticketing), **WH Smith** (travel retail), **Spirax Sarco** (industrial engineering), **Huhtamaki** (packaging) and **Soltec** (solar trackers).

- We made complete exits of **Hoffmann Green** (green cement) and **Teleperformance** (call centre operator). Hoffmann Green suffered during the course of 2022 as investors gravitated away from earlier stage growth businesses in an environment of rising interest rates. Whilst Hoffmann Green's technology looks promising with good commercial prospects, the market capitalisation is too low for us to continue holding the stock. Teleperformance has been a very successful holding for the fund since launch in 2016, considerably outperforming the index and moving into the French CAC 40. We decided to divest our holding of the stock on concerns about working practises in a number of its different geographies and the slow response of management on this topic.

- Elsewhere in the portfolio we trimmed a number of holdings that had outperformed the market, including **ASMi** (semiconductor equipment), **Barco** (visualisation technology) and **Biffa** (waste management). We also cut our exposure to **Fluidra** (swimming pool equipment), **Ceres Power** (fuel cells), and **Afyren** (biochemicals) to reduce risk associate with these positions.

Outlook

- Over recent months the market outlook narrative has evolved slowly but surely. This time last year, there was a degree of panic as inflation rates climbed and central bankers rushed to catch up. At the start of 2023, there are arguably fewer unknowns. Recessions in Europe and the US are expected to be mild, with a relatively unpronounced down cycle for unemployment. The Russian invasion of Ukraine cannot itself be repeated and a similar step by China towards Taiwan remains a low probability. Inflation has topped out. Confidence in the level of terminal rates (if not the date of arrival) is higher. Finally, a lot of the frothiest areas in markets have been significantly rebased. The dollar appreciation trade appears to have run out of steam. This is not to say any of these trends are fully over, but simply that their ability to surprise or to put it another way, their rate of change is diminished vs where the world was a year ago.
- Evidence shows that equity markets move well ahead of events and in this respect, it is important not to position portfolios on the basis of today's news flow as this is more than likely discounted in market levels. The direction of travel is therefore far more important.
- Both the Chinese economic recovery and the US economic resilience make these regions more attractive than Europe. Equity markets have begun 2023 in cheerful mood, but in the past, this has been often explained by inventory rebuild by investment banks rather than fundamental investing trends.
- There are still many hurdles to overcome despite a better overall outlook than 12 months ago. The managers remain in a cautious mood for the time being whilst happy to build positions in stocks where the growth story remains intact.

Sources: UBP.

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