



UBAM – ADAMS US SMALL CAP EQUITY

Quarterly Comment | Q2 2019

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

Market Comment

- ◆ The S&P 500 N.R. finished the quarter in positive territories with +4.15% performance at the end of June. Growth has been in favour this quarter with +4.54%. Value delivered a positive performance as well over the same period with +3.65%. Small caps were underperforming larger capitalization, delivering +1.99% for the quarter. Sector wise, Financial with +6.99%, Information Technology with 5.49% and Material with 5.37% have been outstanding. Energy delivered the worst sector performance with -3.19%, followed by Health Care with +0.97% and Real Estate with +1.64%.
- ◆ The rally in risk assets continued at a good pace in April, and US equities hit new highs. Economic indicators were very volatile with some pleasant surprises: first-quarter GDP growth beating expectations in several countries. The US economy grew 3.2% in Q1, driven by an increase in inventories and lower imports. However, sentiment indicators in the manufacturing sector remained disappointing in April because of ongoing uncertainty about trade.
- ◆ In May, economic indicators were weakened in by renewed concerns about the trade conflict between the US and China, alongside fresh sanctions against Mexico. Manufacturing and services sentiment in the US slid back, reflecting the increased fears about barriers to trade and declining industrial activity.
- ◆ In June, the accommodative tone struck by the major central banks helped both risk assets and safe-haven assets. The G20 meeting saw a truce called between the United States and China and the resumption of trade negotiations. During the month, geopolitical tensions between Iran and the US were ratcheted up, while Mexico managed to avoid having extra tariffs imposed by the US in return for immigration controls. On the economic front, the United States saw industry sentiment continue to slide – a trend which began to spread to services. The uncertainty generated by the trade war triggered a fall in order books and a decline in job creation. Investment showed signs of weakness but consumer spending remained steady despite the deterioration in household confidence. Although inflation dipped under the 2% mark, the Fed did not cut its key rates, rather it floated the possibility of trimming them by 25 bps at some point over the summer.



Performance Review

- ◆ In Q2 2019, difficulties in Health Care and Information Technology offset good results in both Industrials and Communications Services. Within Health Care, Tenet Healthcare, a company that owns and operates general hospitals was the most important detractor to the performance as it did follow the “free-fall” in health insurance stocks in mid-April.
- ◆ In Information Technology, Cardtronics which operates as a cash machine provider was a headwinds for the sectors (after being a major contributor in Q1). Cardtronics share declined following a report highlighting the reduced use of cash vs. electronic payments.
- ◆ In the fund top five contributors (still in stock selection), four companies out of five did belong to the Industrial sector: Advan Drainage Systems, Harsco, Herman Miller and Tetra Tech.
- ◆ In Communications Services, Sinclair Broadcast was one of the main contributors to the performance (like in Q1). The company operates as a television broadcasting company. Sinclair Broadcast agreed to acquire a regional sports networks (RSNs) from Disney.
- ◆ The cash allocation also positively impacted the fund’s performance by generating +0.78% of outperformance.

Portfolio Activity

- ◆ The largest additions during the quarter have been American Renal Associates, Polyone and Quinstreet.
- ◆ The main deletions during the quarter have been Travelport Worldwide, Gray Television and Tenet Healthcare.



Outlook

- ◆ In the US, positive fundamentals and labour market dynamics should support consumption, while net trade and capex should remain subdued. Weakening business sentiment on Q2 points to downside risks to capex and potentially employment if visibility is not restored to the trade and industrial outlooks.
- ◆ Global activity is clearly at a pivot: if the trade war intensifies, recession risks would increase and the economic cycle might derail. If concerns ease and business confidence recovers, the economic cycle should prolong, further benefiting from the recent renewed support from monetary policy.
- ◆ The latest Trump-Xi meeting has relaunched trade negotiations but global risks remain. After China, concerns could increase on Europe as US-Europe trade appears unbalanced. Our base case scenario favours a prolonged truce or partial agreement between the US and other trade partners, but tail risks of protectionism remain high. In anticipation of weakening global demand, exports and industrial activity, central banks have eased their stance and fiscal policy could also be used as a buffer.
- ◆ The Fed should cut rates in the summer, favouring an “insurance policy” as downside risks weigh on activity. The ECB has promised to relax its policy further, via rate cuts or renewed purchases of bonds if the scenario continues to deteriorate.
- ◆ In the US, new proposals for reduced capital gains taxes are emerging in parallel with the debate around infrastructure spending.
- ◆ The US reporting season is already around the corner. While global growth did slow over the quarter, the number of profit warnings has remained relatively low. Moreover, consensus expectations for only flat or negative earnings growth in the cyclical sectors, suggests that companies should again beat analysts’ estimates.
- ◆ The S&P 500 expected earnings growth rate for the full year has held steady (since April) at 3%. Following the slowdown in global growth and the lack of progress on the trade discussions, the downside risk to our “best-case scenario” to see 5-6% EPS growth in 2019 has arguably increased.
- ◆ Despite downside risks to earnings, valuations of most equity markets are back to the highest levels reached over the last 12 months, limiting scope for a strong upward move in equities.

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