UBP FLEX - BELL GLOBAL LARGE CAP EQUITY

Quarterly Comment

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

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Market Comment

- Q4 was a mixed quarter for equity markets. The MSCI AC World Index ended 2021 with a +6.7% quarterly performance, with US and European equities returning +11.0% and +7.7% respectively over the period, whereas Emerging Market and Japanese equities lost -1.3% and -1.7% respectively over the quarter.
- Looking at yearly figures, the MSCI AC World Index delivered +18.5% over 2021, after +16.3% in 2020 and +26.6% in 2019. 2021's strong equity market returns came with a backdrop of strong corporate earnings boosted by a post pandemic recovery in growth, despite supply chain disruptions and rising inflation along with volatility spikes linked to new virus variants and China's regulatory crackdown. At a style level, Quality (+26.1%) outperformed both Value (+22.8%) and Growth (+21.4%) for the year.
- On the macroeconomic front, the US Manufacturing PMI dropped to 57.7 over December, as new orders and production were under continued pressure from supply disruptions and raw material inflation. The employment component was nevertheless stable. The US inflation raised to 7% at the end of the year, mainly driven by energy prices. The Fed announced its plan to accelerate the pace of monthly tapering in January, and the market now expects three rate hikes in 2022.
- Looking at large caps more specifically, the MSCI World Large Cap Index was up +8.32% over Q4, outperforming broader equities. Most sectors contributed positively to the index performance, with IT and Real Estate leading the pack. Communication Services was the only detractor on the other hand.
- Earnings revision ratios remained positive in most regions and sectors over Q4 despite the uncertainty linked to the new Omicron variant spread. Earnings growth expectations for Large cap equities reached a strong +62% in 2021, with another +17% projected for 2022, which outstrips the 7% anticipated for the broader market. Large cap valuations remain relatively attractive against a backdrop of rising valuation risk, with the MSCI World Large Cap Index trading at a P/E of 19.7x at the end of December on a 12-month forward basis, which is a de-rating from recent highs. As valuation risk seems to be concentrated in a handful of large names, active management in that space has never been more important.
- As markets are transitioning to the mid-cycle phase of economic recovery, quality corporate earnings streams and durable valuation floors become paramount. UBP Flex - Bell Global Large Cap Equity offers this "quality at a reasonable price" attribute, being well positioned to benefit from a good array of companies that grow strongly through a cycle along with highly visible revenue streams, strong customer retention and relatively high ESG standards.
- Moreover, we believe that 'quality' earnings should shine in an environment where inflation rises, interest rates tick higher, stimulus dissipates and global economic growth decelerates.

Performance Review

- UBP Flex - Bell Global Large Cap Equity printed a very strong +9.86% (Class IDq USD, net of fees) over the fourth quarter of 2021, outperforming the MSCI World Large Cap Index by 154bps. Since inception in July earlier this year, the Fund has returned +7.46%, which is slightly higher than the benchmark.
- Looking back at 2021, the underlying recovery in demand and profitability across the bulk of industries in developed markets has resulted in strong returns for equity investors and surprisingly strong corporate results, even as economies around the globe and the equity markets in general have faced myriad of headwinds.
- Over Q4, outperformance was primarily driven by stock selection which contributed +147bps, while sector allocation contributed +35bps mostly from the underweight to Financials (9% allocation, 5% underweight). Other sector tilts and currency allocation had minimal effect.
- The companies that contributed most to portfolio returns in the fourth quarter were health management organisation UnitedHealth Group (2.8% position, +74bps contribution) and home improvement company Lowe's (2.8% position, +71 bps contribution).
- UnitedHealth Group is the largest health insurance company in the US, with a top 3 position across end markets: commercial, Medicare and Medicaid. Other businesses include OptumHealth (health and wellness benefits), OptumInsight (healthcare IT solutions) and OptumRx (PBM services). Through a technology driven data platform, they enable improved efficiency throughout the health care system, which leads to better outcomes for patients and the payors that fund them. Increasing spend in the health care industry has helped UnitedHealth grow revenue at nearly 10% per year and EPS at between 13%-16% p.a., which remains the company's longer term goal. Given the earnings consistency of the company, there continues to be strong upside in the shares.
- US home improvement businesses Lowe's and Home Depot were also strong contributors over the quarter, both rising around 27%. They are benefiting from low unemployment rates and strong consumer balance sheets, which is fueling an insatiable demand by customers as they invest in their homes. Recent results have shown solid sales growth and improving margins. In a broader sense, the investment team continues to see good upside in the consumer related stocks, which make up a meaningful part of the portfolio.
- Other positive contributors included US rail operator Union Pacific (2.5% position, +66bps contribution), IT services firm Accenture (2.0% position, +55bps contribution), as well as animal health company Zoetis (1.9% position, +44bps contribution).
- Fortunately and given the strong market conditions, stocks that lagged did not have a significant drag on returns. Fiserv (2.4% position) fell 4% and was the biggest detractor, but only cost 10bps. Hong Kong Exchanges & Clearing (1.7% position) fell the most at -6%, but only cost 8 bps. Other detractors included US telco Verizon (2.7% position, -9bps contribution), and Visa (2.9% position, -6bps contribution).

Portfolio Activity

- The portfolio remained relatively fully invested during the quarter, holding on average 4.3% cash during the period. This is slightly higher than last quarter due to trimming back names that had performed strongly; however, cash will continue to be reinvest into existing names that have better upside.
- From a trading perspective and given the strong market conditions, profit taking helped to reduce valuation risk and volatility. This also allowed the portfolio to stay balanced across style tilts, freeing up capital to take advantage of alpha opportunities from stocks that have good upside while maintaining strong overall ESG metrics.
- The outcome of these trades at a sector level resulted in a reduced exposure to Consumer Discretionary at 15% (3% lower vs. the end of Q3), primarily due to the exit of two stocks: McDonald's and Booking Holdings. Communication Services exposure was also reduced to 9% as Meta Platforms (formerly Facebook) was sold out of the portfolio. The only meaningful increase was to the Information Technology sector, which ended at 26% (2% higher than at the end of Q3) by adding to existing names.
- The decision to exit Meta Platforms was partly driven by valuation and more so concerns around social and governance issues. The group has unsuccessfully dealt with privacy issues, which continues to leave them vulnerable to ongoing regulatory scrutiny, monetary penalties and a potential decline in their franchise and brand value. The company has been immensely successful, growing into a hugely profitable business, but management have not balanced growth with enough focus on improving these problems, hence the decision to exit. McDonald's was also sold after performing strongly leaving very little additional upside, especially given the headwinds from rising costs due to food and labour inflation. Online travel portal, Booking Holdings, was also sold given the risk of further delays in a recovery of the travel sector, which should likely result in profit downgrades and valuation compression.
- No new names were added to the portfolio in the quarter; however, there were some noteworthy changes in existing holdings. Recent weakness in payment network operators Visa and Mastercard, presented an excellent opportunity to add to these strongly growing businesses, which combined now represent over 6% of the portfolio. The position in semiconductor equipment maker ASML was also increased after a pull back. Hospital operator HCA Healthcare and medical device manufacturer Edwards Lifesciences have both recently had excellent results and were also increased. Hong Kong Exchanges & Clearing was also added to after a weak period. Reckitt Benckiser and American Express were also topped up as they represent great value.
- Turning to the current positioning of the portfolio, from a sector allocation perspective, the most preferred sectors remain Information Technology (26% allocation) skewed toward well established, highly profitable names and minimising exposure to the more volatile, high growth names which have more valuation risk. Health Care (16%) is also a large weight with a diversified mix of specialty pharmaceutical, services and device companies. Finally, Consumer Discretionary (15%) is also a significant allocation and includes online retail, home improvement and luxury names. These sectors are reflective of where the investment team finds the highest quality companies.
- In terms of least preferred sectors, the portfolio continues to have no exposure to Real Estate, Utilities or Energy. All are reasonably small in the benchmark and since these sectors are often capital intensive, highly regulated and often reliant on large amounts of debt, they are generally not where the investment team finds companies that meet their high return hurdles.

- From a regional/country perspective, the largest allocation is to the US at 69%, slightly below the benchmark at 71%. The Asia-Pacific region is a smaller part of the benchmark at around 8%, and the portfolio is underweight at 4.5% with just one position in Hong Kong and one in Japan. The remainder of the portfolio is diversified throughout Europe, with the largest allocation being 10% to the UK and the remainder across continental Europe.
- At the end of December, the portfolio's top 5 positions were Amazon.com (4.4%), Microsoft (4.3%), Alphabet (4.0%), Visa (3.2%), and Mastercard (3.1%).

Outlook

- The investment team is mindful that the economy and equities remain sensitive to inflation with the effects already evident in 2021. It will be interesting to see how central banks and politicians thread the needle to manage expectations and engineer a soft landing. The path is difficult to predict, but is likely to result in increased volatility relative to the last 18 months. Interest rates should rise further, albeit not significantly, and this should result in further valuation compression, especially at the speculative end of the market. Remaining disciplined on valuation will be key to minimising the risk of capital loss.
- There are many positive factors that keep the investment team enthusiastic. Supply chain issues shall dissipate, and the team does not expect inflation, rising interest rates or virus variants to cause a market drawdown to the magnitude witnessed early in 2020. Corporate profitability continues to improve, consumer sentiment is stable and households have strong balance sheets.
- More broadly, experienced management teams have helped businesses in the portfolio navigate well through the volatile conditions of the last 18 months. Through good capital allocation, they have maintained high levels of profitability and are thriving with strong market positions.
- The MSCI World Large Cap Index represents good value trading on a 12-month forward P/E ratio of 19.7x. When the investment team analyses the earnings trajectory of the companies from the bottom up, it continues to believe that profit should outperform consensus expectations and grow faster than the market, which gives confidence that 2022 should be another good year for Large cap equity investors.

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