Q1 2020

UBAM – EUROPE EQUITY

Quarterly Comment

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

Market Comment

- Despite starting the new decade in a good mood, the change in momentum of risk markets as 2020 progressed was inevitably noticeable. Investors were already on the lookout for an economic slowdown, but the cycle was interrupted more abruptly than anyone anticipated as the Covid-19 virus spread across regions. As of today, the disease has been declared a pandemic, causing large parts of the global economy to idle and making a global recession a tangible reality.

- Following mixed performance in January where the initial virus impact was offset by the start of the year optimism, the quarter revealed itself to be very volatile, displaying negative returns across the board. The S&P500 index is down -19.6% for the quarter and set a number of records on its way down – fastest -30% decline, most violent peak to trough move and volatility comparable to 2008 despite markets only moving half as much… so far. The MSCI Europe ex-UK returned similar double-digit returns of -20.9%, followed by the MSCI EM at -23.6%. The UK FTSE All-shares was further behind with -25.1% during Q1. All indices are total return in local currency, except MSCI EM in US Dollars.

- A mixed picture on the credit side – higher prices for government bonds due to the announcements of lowered interest rates and the restart of quantitative easing programs but negative returns from the corporate bonds due to the threat of profits being under pressure as industries shutdown. The resulting performance is +8.2% for US Treasuries, +6.9% for UK Gilts and +0.3% for Euro Government bonds ranging from -1.5% for Spain to +1.6% for Germany. This contrasts sharply with corporate bonds which display -5.4% for Global Investment Grade and -14% for High Yield for both the Euro and US regions. All indices are total return in local currency, except global ones in US Dollars.

- Representative of the economic disruption, commodity prices were also hit as demand for most of them declined. Oil prices fell more than most, -60%, due to a combination of lower demand and interruption of the supply constraints between Russia and the OPECs. The one exception is gold which is up +5% this quarter as it tends to be an asset of preference when patterns fail and panic gains the markets. The extent of the hit to the economy is still unknown but a selection of indicators highlights the disruption: Chinese car sales fell by -80% in February, restaurant bookings are down -100% on some mobile apps and US unemployment claims doubled and were nearly 7 million. Most governments and central banks have taken supportive action by issuing government-backed loans or other fiscal stimulus, cutting rates and restarting asset purchase programs in an attempt to mitigate the economic consequences of the virus. This should allow to limit unemployment from growing further and prevent good business from going bankrupt.

- Overall, the first quarter of the year has seen sharp falls on both the equity and credit markets leading investors to navigate an extremely volatile environment with low liquidity. These factors limit the potential for efficient markets and will remain until short-term uncertainty decreases.

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 delivered a net return of -21.36% in Q4 2019 versus a return of -22.59% from the MSCI Europe benchmark, an outperformance of 1.23%.

- Geographically, the strongest performance came from our underweight position in the France and our overweight position in Switzerland. The former can be attributed to the general poor performance of the cyclically exposed French stock market during this period. However, aircraft manufacturer Airbus SE, where the fund does not hold a position, was hit particularly hard. The Swiss market is on the other hand is very defensive in terms of its constituents. Our positions in Roche Holdings AG, Nestle SA and Zurich Insurance Group Limited all positively contributed to performance.

- The largest negative contributors to the fund were our overweight positions in positions in the UK and Belgium. Our overweight in the UK was due to a positive view on the UK economy post the result of last December's constructive general election result which saw a resounding victory for the pro-business Conservative party. However, in the harsher environment brought about the pandemic, this did not serve us so well. The 6 biggest negative contributors were all UK cyclicals or industrials. It is worth noting that, with the exception of UK retailer Marks & Spencer, we have by-and-large maintained these positions as they provide counterbalance to the defensive side of the portfolio and are all high quality companies who will emerge strongly from the crisis. In Belgium, it was our exposure to bank KBC Groupe SA and technology equipment manufacturers Barco NV that hurt the portfolio the most.

- At a sector level, an overweight stance in the consumer staples sector and an underweight stance in Financials both positively contributed to performance. Amongst the consumer staples names it was Nestle, Cranswick, Kerry Group Plc, Remy Cointreau SA and Sainsbury Plc that added the most value. Whilst our overweight position in Zurich Insurance was the only positive contributor to the top 15 outperformers in the fund, our overall lack of exposure, particularly to the high beta banks, served the portfolio well.

- In terms of detractors, our overweight positions in consumer cyclicals and information technology that were the largest negatives. UK domestic retailers and housebuilders were the main culprits on the consumer cyclical side with Marks and Spencer Plc, WH Smith Plc, Ibstock Plc and Barratt Developments Plc all being particularly poor performers. Amongst information technology stocks, our overweight position in Belgian company Barco delivered a negative contribution given its high exposure to the cinema equipment market.

Portfolio Activity

- We entered the current crisis with a strong exposure to high quality stocks with strong balance sheets. This has served the portfolio well in Q1 2020. Even where we have more cyclical names in the fund, they tend to be the best companies in their respective sectors with strong market positions, experienced management teams and a secure financing profile.

- Having said that, the uncertainty surrounding the duration of the pandemic has encouraged us to take some action on the portfolios and activity levels were relatively high for the quarter. Fortunately, we acted early and decisively in a number of situations, particularly where we felt we owned stock in companies that may exit this crisis in an impaired position. Conversely and very selectively, we added to positions and a couple of names to the portfolio where we felt either the company would emerge from the crisis in a stronger position or where we identified a high quality company with a strong balance sheets and great long term franchise which had been punished too hard on valuation in our opinion.

- In terms of purchases we added French luxury goods company LVMH SE, German commercial kitchen equipment supplier Rational AG, Finnish elevator manufacturer Kone Oyj, Britsih engineer Spirax Sarco Engineering Plc, Nowegian recycling equipment company Tomra Systems ASA, British food manufacturer Cranswick Plc, French infrastructure company Vinci SA and German utility E.ON SE.

- On the sell side, we sold positions in insurers AXA SA and Swiss Re AG, banks Intesa Sanpoaolo Spa, ING Groep N.V and Royal Bank of Scotland Group Plc, oil major Royal Dutch Shell Plc, UK retailer Marks & Spencer, German industrial stock Kion Group AG, Swedish telecoms equipment manufacturer Telefonaktiebolaget LM Ericcson, cinema operator Cineworld Group Plc, French car manufacturer Peugeot SA and German chemicals company Covestro AG.

Outlook

- The current pandemic dominates the narrative regarding the outlook at the moment. On one hand we have little visibility as to how and when economies normalise. The short term impact is well understood but the longer term impact is difficult to fathom. On the other hand, every crisis throws up opportunities. We remain vigilant regarding market risk but we are very much keeping an eye out for these value opportunities, particularly where the market has treated high quality companies too harshly in our opinion.

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