THE DRIVE YOU DEMAND

UBAM - EUROPE SMALL CAP EQUITY

Quarterly Comment | Q3 2019

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

Market Comment

- The third quarter finished with broadly flat performance due to a series of monthly swings which offset each other – similar to what was observed during Q2. Indeed after a relatively flat month of July, the European market saw a slowdown during the first half of August which was subsequently offset by a recovery from mid-August. This continues to be stimulated by the uncertain outlook and weakening global economic data causing rapid changes in investor sentiment – although the latter was partly offset by monetary easing from the Federal Reserve (Fed) and European Central Bank (ECB).

- Overall, the late summer bullishness resulted to a quarter with +2.5% expansion of the MSCI Europe ex-UK index, while the US S&P500 and UK FTSE100 markets were up by similarly low levels, 1.7% and 1.0% respectively. The emerging markets finished the quarter in negative territory, with the MSCI EM down -1.9%. The strongest performance was observed on the fixed income side, as central bank help supported government bonds – the return on Euro Treasuries came in at +3.8% followed by US Treasuries at +2.4%, while global Investment Grade credit delivered +1.2%.

- The resulting year-to-date performance remains strong in developed economies. The Europe ex-UK market leads with performance of +21.1%, followed by the US S&P500 which returned +20.6% and by the UK's +14.3% returns which continue to be pressured by the slow-moving Brexit process. Emerging markets lost some growth this quarter, resulting to +8.1% year-to-date.

- As indicated during our monthly reviews, the continued economic slowdown in the US led the Fed to cut interest rates in both July and September as an attempt to offset the weaker growth and hiring rates which are stimulating a consumer confidence decline. The slowdown and uncertainty was further fuelled by the trade wars; the current outlook is that unless otherwise negotiated, tariffs will come into action by the end of the year.

- Similarly, the ECB lowered interest rates into the negative territory and restarted quantitative easing to try and achieve its inflation target. Europe continues to show signs of a slow economy, particularly in the manufacturing sector and with indications that this has started spilling over to the service sector.

- In the UK, parliament passed a legislation forcing the government to ask for an extension if no deal is found with the EU. The GBP reacted positively to this but the Bank of England stayed on hold until it gets more visibility on the economic outlook. Indeed, wage inflation is at 4% so depending on the outcome of Brexit the BoE could face either scenario of having to raise or lower rates.

- Overall, this quarter confirmed the economic slowdown which is increasingly visible on market performance. For the near term, investors will most likely be on the lookout for developments with Brexit, the trade wars, and any potential escalation of Middle-East tensions.

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Performance Review

- During the third quarter of 2019, the UBAM Europe Small Cap Equity Fund fell by 0.84% compared to a return of +1.62% from the MSCI Europe Small Cap Index. Year to date the fund has returned +17.11%, against the index return of 17.62%.

- Stock selection detracted from relative returns during the quarter, with disappointing returns from consumer discretionary and energy related holdings. Stylistically, the fund also suffered slightly from a shift away from quality growth stocks, which had performed strongly as a group in the first half of the year, into more value oriented areas of the market.

- Notable detractors in the third quarter included bike rack and cargo carrier company Thule, oil service equipment company Schoeller Bleckmann Inc, and recreational vehicle and marine equipment company Dometic Group AB. After strong returns in the first half, Thule Group AB suffered on concerns about the impact of tariffs on consumer purchases of bicycles in the US. We believe that while the short term trading environment may present some challenges, the company is well placed to continue to drive strong sales growth in the medium to long term given its market leadership position, strong brand and new product development initiatives. Schoeller Bleckmann fell following its Q2 results which fell slightly below expectations on sales and EBITDA, but which were well ahead on free cash flow generation. We believe the valuation is extremely attractive at sub 7x EV/EBITDA and 10x EV/EBIT for a global leader with very strong market positions. Dometic fell on the back of weak data on the RV (recreational vehicle) market in the US and on general macro and trade related concerns. The company is very much a self-help story with the new management team (ex Assa Abbloy AG) doing a fantastic job in repositioning the product portfolio, working on manufacturing efficiencies and reducing working capital.

- Elsewhere on the fund, the strongest contributors to relative returns included online ticketing company CTS Eventim AG, animal health company Virbac Group S.A, and business services company Teleperformance SE. CTS Eventim reported very strong first half earnings figures in August, and confirmed a strong outlook for the full year. The company also announced a strategic partnership with France Billet, the leading French online ticketing company, representing a positive deployment of cash on the balance sheet. Virbac, a new holding onto the fund earlier in 2019, reported strong first half figures. The report confirmed that the company is well on track in its recovery in the US market, which is helping to drive a strong improvement in earnings and cash generation. Finally, Teleperformance extended its share price gains after upgrading its full year organic growth targets, highlighting an improvement in the EWAP region and in specialist services.

Portfolio Activity

- During the quarter, we introduced a number of new holdings to the fund, including multi technical services company SPIE, online financial services company Finneco Spa, and computer gaming software company Stillfront Group AB. SPIE's first half earnings confirmed that the company is experiencing good progress in its core French and German markets and we expect that a continuation of the strong organic growth trends, improving cash generation and a very attractive valuation will drive continued interest in the shares. SPIE is heavily involved in facilitating energy transition and efficiency for its commercial customers and we believe this will help to drive demand for its services for the foreseeable future. Finneco is the leading online financial services company in Italy, with a strong position in brokerage, but with increasing strength in transactional banking and savings products. The company stands to continue to take market share from a fragmented and poorly invested peer group and the shares look attractively valued after a core shareholder fully exited the register in a short period of time. Stillfront is one the leading developers in the niche and growing video game category of strategy games. The company is highly disciplined in its approach to development and marketing spend, something which differentiates it from some of its peers. Recent acquisitions have transformed the company's earnings profile and it is well positioned to benefit from ongoing organic and external growth opportunities. Stillfront trades on a discount to the peer group as it is still relatively unknown due to its sub €1bn market capitalisation.

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- We exited our holdings of C parts logistics services supplier Bufab AB, industrial equipment manufacturer FLS, and Spanish bank Liberbank SA. Our sales of Bufab and FLS were driven by concerns about deteriorating conditions in the end markets of both companies. We sold Liberbank to free up capital to invest in Finneco, a financial company which represents a step up in quality and growth characteristics for the fund.

- Elsewhere, we added to existing holdings of Virbac, Applus Services SA, Ibstock PLC, Sanoma OYJ and Huhtamaki OYJ during the quarter, primarily on our confidence about the outlook for these companies going into 2020 and beyond. We trimmed our holdings of GTT, Alk Abello A/S, Arcadis NV, Teleperformance, and Barco NV, following strong gains in their share prices during the course of the year to date.

Outlook

- European equity markets have recovered significant ground in the first half of 2019, against a backdrop of deteriorating macroeconomic conditions and slowing earnings growth, boosted by a more accommodative stance from central banks. We believe that there is a chance of continued market volatility into the latter period of the year as we see evidence of further deterioration in the outlook for corporate earnings coming into the third quarter earnings season. Nevertheless, any sign of stabilisation of economic indicators combined with an improvement in international trade discussions or a resolution of the Brexit negotiations, could provide positive impetus for equities.

- Against this backdrop we maintain a more balanced portfolio with a good blend of quality growth business with sustainable returns and companies with improving returns, self-help stories which can drive earnings and cash flow regardless of the economic backdrop. We continue to find opportunities to invest in high-returning, competitively advantaged business that we believe can become future bigger companies, especially given the inefficiencies inherent in the small and medium capitalisation segments of the market.

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