Q3 2020

UBAM – EURO EQUITY INCOME

Quarterly Comment

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

Market Comment

- After a strong Q2 with widespread positive performance, the third quarter of 2020 shows regional disparities reflecting the local evolutions of Covid19. Indeed, as the different containment strategies yield their results, the spread of the virus is not uniform across countries and stimulates a range of economic responses – resulting in different market performance between regions. The gap between growth and value stocks also persists as growth companies are up +19.2% year to date while value is down -14.1%, in Europe. A cold winter without enough positive vaccine development news would be negative for value stocks and widen the gap further.

- In year to date terms, the S&P500 is the leading index with +5.6% return followed by MSCI EM with flat performance and ahead of the MSCI Europe ex-UK index displaying -7.4% returns. The lack of progress of Brexit negotiations and the fading fiscal stimulus causes the UK to lag, with the FTSE All-Share down -19.9%. Following the Internal Market Bill which seeks to modify the terms of trade between the UK and Northern Ireland, the most likely Brexit scenario is a limited free trade agreement with significant arrangements to ease the transition.

- While hospitalisations in Europe and the UK seemed under control during the summer, the effect of travelling abroad for the holiday season lead to a new rise in the number of cases – most notably in Spain, France and the UK. This fueled concerns that dropping temperatures in Autumn could lead to a second wave of Covid19 and caused European equity markets to lag as the MSCI Europe ex-UK index returned +1.8% and the UK FTSE All-Share was down -2.9% this quarter. The worsening sentiment is also displayed by volatility levels – the VIX index has increased to the 25-35 range during September compared to the 20-25 levels in June and July.

- The United States experienced a rise in cases at the start of Q3 but thanks to the use of face masks was able to reduce hospitalisations significantly from the end of July. Combined with the transition to online commerce, this resulted in strong performance from US technology and growth companies for most of the quarter. Unemployment also displayed a modest reduction, but as valuations expanded and the risk for a vaccine-driven rotation increased in September, the market slowed down to favor cheaper stocks. This resulted in a quarterly return of +8.9% for the S&P500.

- Emerging markets performed strongly too as the MSCI EM index returned 9.7%. Similarly, MSCI Asia ex-Japan was a notable performer of the quarter with 10.8% returns, stimulated by China's success in containing the virus after the first wave.

- Credit markets display lower performance than previous periods, but positive, nonetheless. On the corporate side the US high yield rallied by 4.7% during the quarter, followed by Euro high yield which was up 2.5%. More broadly, the Global Investment Grade instruments returned +3.1% during the period. Similarly, Euro Government bonds returned +1.7%, followed by US Treasuries at +0.2% UK Gilts down -1.3%.

- Overall, an undeniably uneven quarter, but investors will now prepare for an eventful end to the year – the US election outcome will soon be known, a Brexit scenario will be determined, and news on a potential vaccine could accelerate – which would be a game-changer for the market and help many stocks that have lagged throughout the year recover.

- All indices are total return in local currency, except global ones in US Dollars.

Performance Review

- The fund delivered a net return of +3.07% in Q3 2020 versus a return of +0.30% from the MSCI EMU NR benchmark, an outperformance of 2.77%. (performance shown net of fees, IC EUR share class)

- Geographically, the strongest performance came from our overweight position in the Finland and our overweight position in Sweden, although the former was the more significant effect. The Finland outperformance can be attributed to the positions in Finish Industrial stock Kone Oyj which an international engineering and service firm; and the Financial company Sampo PLC. The Swedish outperformance can be attributed to overweight in Thule Group AB (which is a company that owns collection of brands related to outdoor and transportation product), and to the overweight in the industrial company Atlas Copco AB.

- The largest negative contributors to the fund were our overweight positions in Portugal and our overweight position in Belgium. The Belgium underperformance can be attributed to the overweight in KBC Groupe SA. The Portugal underperformance can be attributed to our overweight in the energy company Galp Energia SA.

- At a sector level, an overweight stance in the industrials sector and an underweight stance in Material both positively contributed to performance. Amongst the industrials names it was our holding in Kingspan Group Plc, Kone Oyj, Rational AG and IMCD NV that added the most value. An underweight in the Material sector also contributed positively good stock selection in the Swiss stock Sika AG, and German company Covestro AG which they both contributed positively the portfolio.

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.

- In terms of detractors, it is our underweight positions in Consumer Discretionary and our overweight in Energy that were the largest negatives. For consumer discretionary, not being exposed to the German automotive corporation Daimler AG, the German multinational sports shoes and clothing corporation Adidas AG, and the French luxury goods company Kering SA were the most negative contributors. For Energy, the negative effects are mainly due to our overweight in one position: the Portuguese stock Galp Energia SA.

Portfolio Activity

- We entered the current crisis with a strong exposure to high quality stocks with strong balance sheets. This served the portfolio well in Q1 2020. As we entered the second and third quarter, we recognized that many value/cyclical stocks had been hard hit and that selectively there may be some opportunities. We therefore took the decision to selectively build up positions in these to protect the portfolio from the “bounce back” effect of economies re-opening.

- We focused our attention on those names 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 Italian multiutility company Hera SpA, and Belgium based Real estate company Warehouses de Pauw NV, we also continued to build on some of our important themes, particularly those focused on sustainability, healthcare and the technology revolution. We added swiss multinational pharmaceutical company Novartis AG. We purchased holdings in Finnish telecommunication stock Elisa Oyj and Italian healthcare company DiaSorin SpA. Elsewhere we purchased holdings in German insurance company Munich Re Group and Sika AG: a Swiss multinational specialty chemical company that supplies to the building sector and motor vehicle industry.

- On the sell side, we predominantly financed the purchases through the reduction in position size of some of our large stocks. We took profits in Netherlands Energy stock Royal Dutch Shell PLC and Netherlands Financial ING Group NV.

- We reduced our position size in Portuguese Energy stock Galp Energia SA and UK industrial company Melrose Industries PLC. Also, we trimmed our position size in Spanish Multinational electric utility company Iberdrola SA, UK multinational beverage alcohol company Diageo PLC, Spanish bank Bankinter SA and German multinational financial services Allianz SE.

Outlook

- Q4 2020 will witness a number of significant events. At the start of the quarter it seemed possible that the US Presidential election may see some kind of delay after the announcement from the Republicans that Donald Trump was actually Covid positive. However, his discharge on the 5th of October would suggest that the election will go ahead as planned despite the fact that so many of the presidential team are currently carriers of the infection. The result of the election will have long term ramifications for stimulus packages and also future taxation rates.

- In Europe an end to the Brexit negotiations will happen one way or another and we would expect this clarity to actually lead to an appreciate of the euro vs the dollar given that there will at least be a basis of fact on which to build policy in the bloc. However, more broadly, the outlook looks constrained like a straight jacket. On one side, conditions will not be permitted to deteriorate for the economies of the world at large. On the other side, were we to witness substantial improvements we would expect finance ministers to start to focus on measures to pay for the financial support they offered during the tough days of 2020.

- This narrow path of travel will surely lead to a need to focus on strongly capitalised companies that offer some control over their own destinies. Overriding all of this is the observation that governments have reached for the Green and Social Agendas when looking to reflate their economies. This has proven hugely influential in the challenge of scaling up a less harmful industrialised world, a trend which provides a strong following wind for investors in sustainably enlightened strategies.

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