UBAM (CH) – SWISS SMALL AND MID-CAP EQUITY

Quarterly Comment

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Market Comment

- Over Q3 2023, most global equity markets ended in the red with the MSCI AC World down -3.4%. Swiss equities lost -3.3%, US equities -3.3%, Emerging Market equities -2.9% and European Equities -2.1% while Japanese equities gained +2.4%. The SPI Extra lost -5.7%, bringing its YTD performance to +3.7%, versus +4.6% for the SPI and +10.1% for the MSCI AC World (performance in local currencies).
- In the US, inflation came in as expected in August with the yearly CPI trend rising to +3.6% y/y due to volatile energy prices and resilience in core inflation. The Fed did not change its key rates, although they suggested that a further increase may happen before year end. In the Eurozone, CPI and core CPI yearly trend slowed to +5.2% y/y and +5.3% y/y respectively. The ECB raised interest rates by +25bps and indicated that while a peak might have been reached, interest rates would probably stay elevated. As for business confidence, the US manufacturing PMI increased from 47.6 to 48.9 in September. In Europe, the manufacturing PMI remained stable at 43.4 compared to 43.5 in August but is still well below the 50 mark.
- The September earnings revision ratios remained in positive territory for developed markets, just above zero in Europe, but higher for Japan and US equities. 2023 EPS growth projections for global equities have remained very close to 0% since February, with current bottom-up forecasts at -2% for Europe (but +3% ex-energy) and at +1% for the US. Over the last month, the global equities' 12m forward PE continued to edge lower to 15.6x, just below its long-term average, still with large differences between regions. For instance, Europe and EM are trading at around 12x while the US stand at nearly 18x. Earnings growth expectations stand at a solid +7.8% for 2023 and +9.6% for 2024 for Swiss equities, trading at 16.9X PE ratio, the lowest level this year.
- In Switzerland, the SNB left interest rates unchanged at 1.75%, indicating that the level should be sufficiently restrictive given the outlook on inflation. The yearly inflation trend remained stable in September at +1.7% y/y, and PPI-import prices were down by -0.2% m/m. The leading KOF indicator slightly dropped from 96.2 to 95.9 at end of September. Business sentiment continued to recover however from depressed levels with the PMI Manufacturing increasing from 39.9 in August to 44.9 in September.
- In Q3, Financials and Real Estate were the best contributors to the SPI Extra's performance, while Industrials and Healthcare were the largest detractors. In terms of individual names, Adecco, Julius Baer and Swiss Prime were the best contributors, whereas Straumann, Georg Fischer and SGS were the largest detractors.

All performance figures are given gross of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Performance Review

- UBAM (CH) - Swiss Small and Mid Cap Equity delivered -6.6% in gross performance in Q3 2023 versus -5.7% for the SPI Extra. Over the quarter, sector allocation was the main detractor from relative performance (-77bps), particularly the underweight in Real Estate. Stock selection detracted as well (-11bps), especially in the Materials and Industrials sectors. YTD, the fund is up +3.9% vs +3.7% for its benchmark.
- Over Q3, the biggest contributors to performance were overweight in ALSO, the underweight in Straumann and the overweight in VZ Holding (+27bps, +21bps, +20bps respectively). ALSO rose more than 19% after posting solid results for H1, with high cash generation, with guidance being confirmed for FY23. Straumann was down -19.3% over the period. Its share price fell after the company flagged ‘isolated pockets' of consumer weakness and reported net profit for H1 that missed expectations due to higher hedging costs. VZ Holding was up +16.2% after reporting strong H1 results and guidance for the rest of 2023.
- The main performance detractors over the quarter were the absence of exposure to Adecco and Swiss Prime Site as well as the overweight in Meyer Burger (-57bps, -27bps and -35bps respectively). Adecco gained +29.2% in Q3. Despite reporting weaker margins and earnings than expected for Q2, the market reacted positively to the company‘s market share gains, robust organic growth, and cost control. Swiss Prime Site was up +8.1% after closing the first half of 2023 with strong operating results and confirming its guidance for the rest of the year. Meyer Burger was down -38.6% after the company withdrew its forecast to achieve breakeven on EBITDA level for 2023 due to continued pricing pressure from Chinese suppliers in the European markets.

Portfolio Activity

- Over the third quarter of the year, the position in Komax was sold on the back of a worsening automotive outlook. The position in Meyer Burger was also sold given the deteriorating outlook for the company and consequently its CFROI® (Cash Flow Return on Investment. Source: Credit Suisse HOLT) profile.
- On the other hand, a position in Aryzta – producer and retailer of specialty bakery products – was initiated given their strong volume and margin progress, together with industry-leading cost control. Several semiconductor related names such as VAT, Comet, Inficon and even Georg Fischer (whose specialized piping solutions are used in fabs) were reduced due to some hesitancy regarding short term performance in view of the delayed turnaround in semiconductor equipment, which affects suppliers to the industry. The position in Barry Callebaut was reduced given poor operational delivery despite decent market demand.

Outlook

- Commodity related sectors as well as healthcare names have dragged global EPS growth expectations into slightly negative territory for the full year 2023. The team sees an attractive opportunity to maintain exposure to Swiss equities given their current valuation levels and resilient and visible earnings picture, combined with Switzerland's advantageous macroeconomic positioning. While the gap between the expected EPS growth of the Swiss market vs. global equity markets has been increasing since the beginning of the year, this has not yet been reflected in the Swiss market's relative performance, which provides some upside potential for the remainder of the year, also supported by structural growth drivers.

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- The Swiss Small & Mid Equity Strategy continues to focus on the bottom-up selection of value creative names and is well positioned in the current environment. Firstly, the companies in which it invests have strong fundamentals: low debt levels, solid balance sheets and benefit from strong pricing power. After the deterioration of macroeconomic indicators over the summer, there is a strong argument for investors to return to companies with stronger fundamentals over the last quarter of the year. Moreover, an environment marked by higher interest rates and inflation levels that continue to be much above average levels observed in the past couple of years should be helpful for the companies with strong pricing power (a key component in the creation of value). Secondly, the strategy offers exposure to a selection of leading Swiss small and mid-cap companies that benefit from structural growth drivers and are thus less dependent on the global macroeconomic environment. Oftentimes, these companies have exposure to growth markets and benefit from high entry barriers linked to strongly innovative products and services.

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