Q1 2021

UBAM (CH) - SWISS SMALL & MID CAP EQUITY

Quarterly Comment

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Market Comment

- Major equity markets ended the first quarter of 2021 in the green with the MSCI AC World gaining 4.6%. European equities took the lead in Q1 with a return of 8%, followed by Japanese and US equities with 6.9%, Swiss equities with 5.2% and Emerging Markets with 2.5%. Over the period, Swiss equities have outperformed global equities by 0.5%, and the SPI Extra has delivered even better returns with 8.9% over Q1 2021.
- The year started with some volatility following concerns around the deployment of Covid-19 vaccines and the evolution of virus variants. The start of the earnings season however revealed positive earnings momentum for cyclical sectors, including financials and technology. This trend was met by investor optimism for a gradual lifting of confinement measures as vaccination rates progress and promises of continued stimulus and amplified by rising Treasury yields and commodity prices as well as falling credit spreads. The consequential expectations for significantly accelerating global GDP growth led to a significant rebound of “beaten down” sectors like energy and metals & mining.
- Global equity valuations declined slightly to 19.4x 12-month forward PE ratio at the end of March, while earnings growth expectations rose back to 30% for 2021 as a result of an improving revenue outlook and strong cost management. However, 2021 earnings growth expectations still show large divergences between regions with +26% for the US, +33% for the Eurozone, +18% for China and +37% for Emerging Markets. While the expectations for Switzerland with +9.5% earnings growth are more benign, earnings visibility is much better given the limited exposure to cyclical sectors such as energy and consumer discretionary with potentially overly optimistic earnings revisions for 2021.
- The SNB left its policy rates unchanged but revised its inflation expectation upwards to 0.2% for 2021. The unemployment rate stood at 3.6% at the end of March and the KOF indicator rebounded strongly to 117.8, the highest level observed since 2010. The manufacturing PMI also showed an improvement in sentiment increasing to 66.3 at the end of March.
- Over Q1 2021, all sectors of the SPI Extra finished in the green with defensive sectors recovering over the month of March. More cyclical sectors like Industrials, Financials and Information Technology were the top contributors to the index’s performance over the period. In terms of individual names, Kuehne + Nagel, Logitech and Julius Baer were the biggest contributors while Vifor Pharma, Lindt and Tecan were the largest detractors.

Performance Review

- UBAM (CH) – Swiss Small and Mid-Cap Equity delivered an absolute gross performance of +9.0% over the quarter, versus +8.9% for the SPI Extra. Stock selection, particularly in the Consumer Staples sector, has been a strong contributor to relative performance (+99bps). This was partly offset by the underweight in Industrials (-43bps) as well as the overweight and stock selection in Healthcare (-17bps and -53bps respectively).

- Over Q1, the biggest contributors to performance were the overweight in Zur Rose, the underweight in Lindt & Spruengli and the position in Partners Group (+57bps, +60bps and +28bps respectively). While Zur Rose disappointed with a higher than expected loss for 2020, the strong sales growth guidance of 20% for 2021 as well as the new mid-term targets the company provided, reassured investors and the stock ended the quarter up more than 25%. Lindt on the other hand lost 2% over the period as the company reported a big drop in profitability due to the continued lockdowns and only slightly raised its 2021 topline guidance. Partners Group gained 16% over the period as the company delivered a solid beat of consensus net income expectations for 2020 driven by a strong recovery of performance fees in the second half of the year and gave a confident outlook for 2021.

- The main performance detractors over the quarter were the absence of exposure to Julius Baer and Schindler as well as the overweight in Cembra Money Bank (-36bps, -29bps and -28bps respectively). Julius Baer and Schindler were both up 18% over the quarter mainly driven by the cyclical rotation. Cembra Money Bank lost 2.9% after it reported a decrease in revenues and net profits due to the effects of the pandemic. The company expects a recovery in sales for 2021 with a pickup of economic activity supporting their personal loan and credit card businesses.

Portfolio Activity

- Over the first quarter of the year, the team decided to exit its position in PSP Swiss Property over concerns about the medium term resilience of the office and commercial rental market in Switzerland. On the other hand, the team initiated a new position in Kuehne & Nagel. The latter is a high-quality cyclical company with good opportunities in an improving economic environment, which currently also benefits from providing solutions for complex freight forwarding processes, for the Covid-19 vaccines rollout for instance but also in the context of newly erected trade barriers. A new position was also initiated in Ascom following solid results for 2020 with growth on incoming orders as well as operational profitability improvements. The team sold its position in Vifor Pharma on concerns over its growth guidance, despite being in part compensated by higher profitability expectations. On the other hand, the team built a new position in Georg Fischer following resilient numbers reported for 2020 and ambitious targets. The industrial company expects sales growth in the mid to high single digit and an increase in profitability in 2021.

Outlook

- Swiss equities present a compelling investment opportunity for the short term with a long-term advantage. Delivering attractively priced and more visible earnings growth for 2021, Swiss equities provide sustainable and high value creation potential combined with strong ESG characteristics, like a low average carbon footprint, which are structurally in favour of high cash flow returns on investment.
- The new and improved normal that is emerging post-pandemic will be accompanied by changing consumer and investor habits with an increased attention to ESG and especially climate change. Focusing on high and sustainable value creation combined with attractive ESG profiles – as implemented in the strategy – should allow investors to navigate this new dynamic by offering exposure to long term structural trends as well as global growth recovery beneficiaries

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