THE DRIVE YOU DEMAND

UBAM - GLOBAL EQUITY SUSTAINABLE GROWTH

Quarterly Comment | Q4 2018

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

Market Comment

- All major equity markets ended the year in red with the MSCI AC World TR USD dropping -13% over the last quarter of 2018. The MSCI North America recorded the leading loss over Q4 2018 (-14.6%), followed by the MSCI Europe (-11.7%) and the MSCI Emerging Markets (-7.8%). On a full year basis, the figures are also negative with the MSCI AC World TR closing 2018 down 10%.
- Over the fourth quarter of 2018, the only sector posting positive performance was Utilities while Information Technology erased Q3 gains and dragged the MSCI AC World down -2.7%. Financials were also a big detractor to performance, costing Q4 -2.1% in returns. Over the full year 2018, only Healthcare and utilities ended the year on a positive note as investors pursued defensive names.
- October and December brought significant losses and important swings in major stock markets sparking fears that the deep corrections are leading the path to a bear markets. Uncertainty factors for investors mounted towards the end of 2018 around global growth, trade war fallouts as well as political concerns around Brexit and the government shutdown in the US.
- In terms of economic growth indicators, manufacturing indices also gave mixed signals. Over the last quarter of the year, the US, China, Germany and France saw their PMI levels deteriorating with the US ISM PMI dropping to 54.1, the lowest level in two years, however still holding up above the 50 level, i.e. in expansionary territory. Japan, Brazil and Russia continue to post low but stable PMI levels.
- Late 2018, earning revisions ratios turned negative in all major regions. While US earnings expectations for Q4 2018 remained positive at 16% growth year-on-year – in line with historical patterns – Q1 2019 estimates started reflecting lower trends (10% growth year-on-year) linked to the fading effect of corporate tax cuts on earnings and rising costs. 12-month forward P/Es dropped to multi-year lows for most global equity markets – pricing in an even more significant slowdown in earnings in 2019. In December 2018, consensus 2019 profit estimates were cut for more than half of the S&P 500.

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

- UBAM - Global Equity Sustainable Growth was down -17.8% at the end of the fourth quarter 2018, underperforming the MSCI AC World index by 5%. The fund's relative performance over the full year 2018 was also recorded at -5%.
- Stock selection was the main detractor of performance over Q4 as well as for the full year 2018 (-2.5% and -3.9% respectively). Sector allocation was also a drawback with -93bps contribution in Q4, with the underweight in Consumer Staples detracting 27bps given that this sector held up better over the quarter.
- The best stocks contributing to the relative performance over Q4 were the overweight in NextEra Energy (+32bps) and BHP (+21bps), and the underweight in Apple (+29bps). NextEra was up 4% over the quarter after reporting solid Q3 results with 6 to 8% EPS growth outlook supported by lower income tax on renewable assets and minimal exposure to short term commodity price swings. Apple ended Q4 2018 down close to 30%, suffering from weakness in China and lower iPhone replacement activity. BHP was up 4% over Q4 after announcing in its investor day a capital allocation move from typical cyclical mining momentum to value investing in order to maximize shareholder value.
- The biggest detractors were the overweights in United Rentals (-51bps), Ashtead Group (-46bps) and EOG resources (-40bps). United Rentals price dropped 37% over Q4 despite excellent quarter results and positive outlook conveyed by management. The company suffered from the cyclicality of demand linked to recession fears as well as the rising interest rates pressure on its balance sheet debt. Ashtead Group was down 34%, also driven by a downgrade based on an analysis of the current economic cycle. The company continued to publish good results with expectations that the full year results to beat estimates from stronger demand for renting industrial gear. EOG also reported positive quarterly results however struggled with the slump in oil price over the period.

Portfolio Activity

- During the month of October, the position in Samsung was exited on ongoing DRAM price pressure and reduced capex signaling weaker business outlook. The exposure to Facebook was also ended ahead of Q3 reporting which was expected at the time to show slowing growth and rising costs to handle contents issues. A new position was initiated in Thermo Fisher, the lab equipment and consumables maker with a strong 32% to 38% CFROI generation, supported by rising asset turns.
- In November, the remaining position in Apple was closed on its ongoing supply chain weakness and ending iPhone unit sales reporting. The exposure to Abbott Laboratories was increased given its attractive exposure to Medtech, EM generics and nutrition, which should support revenue growth superior to 6% and a rising CFROI helped by margin and asset turns expansion.
- The team decided to reduce throughout December the exposure to the energy sector, where expectations of strong earnings growth should be revised to falling earnings given the recent sharp fall in oil prices. Existing positions in EOG, OMV and Occidental Petroleum were accordingly reduced. EOG is one of the most efficient shale oil plays and projects are profitable also at current spot prices. OMV should be partly protected by posting stronger margins in their significant refinery business. Occidental Petroleum should continue to benefit from oil transport related earnings, even at the current price of oil.

Outlook

- There has been an expectation that growth will slow down in 2019 globally. Note the reference to slower growth, but growth is still expected in 2019. It would not be surprising to see this number revised down, after what may turn out to be a difficult fourth quarter and in view of the high base that needs to be overcome in the first half of the year in terms of earnings growth. However, the second half of 2019 is likely to be more benign in terms of the base and companies may be able, from then on, to show healthy earnings growth, based on the team's expectations of a continued supportive macro-economic back drop.
- In this context, the team continues to expect volatile markets in the coming months (VIX above 20 not unlikely) and possible further downgrades in earnings growth as companies may give conservative guidance during Q4 2018 reporting seasons. In the relatively supportive global economic scenario the team maintains its strong conviction in names with stable / high CFROI whose growth drivers are sufficiently solid to limit risks of earnings warnings or downgrades.

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