UBAM - SWISS SMALL AND MID-CAP EQUITY

Quarterly Comment

Marketing Communication
For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws.
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Market Comment

- Supported by optimism around a softer landing in the US, the AI hype and soon to come interest rate cuts, equity markets continued their climb in Q1 2024, with many of the main indices making new all-time highs. In March, performance drivers started to broaden with energy and banks contributing positively, as investors were looking for attractively priced areas of the market away from the diverging “Mag 7”. The MSCI AC World rose +8.1% over the quarter, with Japanese equities up +17.3%, US equities +10.6%, Swiss equities +6.0%, European equities +7.6%, and Emerging Market equities +2.1% (performances as of 28.03.2024, in local currencies).

- US GDP growth for Q4 23 came in slightly above estimates at 3.4% qoq but showed some slowdown from the previous quarter. Activity is expected to moderate in Q1 2024, but average growth for the full year should remain in a 2%-2.5% range after 2.3% in 2023. This would support the soft-landing scenario as US consumers continue to benefit from a tight employment market. The US Fed announced no change in key rates during their March meeting, as inflation remained elevated, coupled with solid activity and strong labor indicators. The US yearly inflation trend increased for end of February from 3.1% to 3.2%. EPS growth expectations for US equities stand at 10% for 2024, with valuation edging slightly higher to 20.9x fwd PE ratio. This rerating continues to be mainly driven by the large cap tech companies, that are still gaining in weight in the indices, and boast high profitability and earnings growth. Nevertheless, the dominant Magnificent 7 trade continued to show divergences with Tesla and Apple posting losses YTD.

- In a surprise move against most predictions, the Swiss National Bank lowered its key rate from 1.75% to 1.5% in March, as inflation stabilized well below its 2% target since June 2023. The manufacturing PMI for Switzerland came in higher than expected and the prior print, at 45.2, but still below the 50 level. Business sentiment had notably improved on production, new orders, and employment. The leading KOF indicator remained stable for end of March at 101.5, compared to 101.6 for the prior month. EPS growth expectations for Swiss equities still stand at 10% for 2024, with an 18.8x fwd PE ratio. Compared to 9% EPS growth expectations for global equities at 17.9x fwd PE ratio, and to US equities, Swiss equities continue to offer attractively priced investment opportunities for 2024.

- Over Q1 2024, Industrials, Financials and Healthcare were the best contributing sectors of the SPI Extra, while IT, Utilities and Consumer Discretionary detracted the most. In terms of single names, SGS, VAT Group and Julius Baer were the best individual contributors, while AMS, Adecco and Temenos were the largest detractors.

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Performance Review

- UBAM - Swiss Small and Mid Cap Equity delivered +6.6% in gross performance in Q1 2024 versus +4.6% for the SPI Extra. Over the quarter, both stock selection, particulary in IT and Financials, and sector allocation, notably the overweight in Industrials and the underweight in Real Estate, had positive effects with +105bps and +91bps respectively.
- Over Q1, the largest contributors to relative performance were the absence of exposure to Adecco, AMS and Temenos (+43bps, +41bps, +39bps respectively). Adecco dropped -13.6% over the quarter. The company reported mixed Q4 2023 results and investors probably remain concerned about the macro environment with temp staffing data in some of its key markets not showing any improvement in the first months of this year. AMS was down -50.4% after the company had to announce the cancellation of a key micro-LED project of its major customer, forcing the company to reassess its micro-LED strategy. Temenos' share price lost -17.6% after a well-known short seller published a report accusing Temenos of major accounting irregularities.
- The main performance detractors to relative performance over the quarter were the absence of exposure to SGS, the exposure to Kuehne + Nagel and the overweight in Sensirion (-60bps, -25bps and -18bps respectively). SGS rose +20.6% after the company announced that CFO Géraldine Picaud will take over as CEO and laid out new 2027 targets at a strategy update at the end of January. Kuehne + Nagel was down -13.4% as Q4 2023 results missed expectations across the board. The continued subdued demand backdrop also led management to announce a restructuring programme to optimise its cost base. Sensirion dropped -20.0% as ongoing demand weakness in key markets led to the company reporting sales that missed consensus estimates as well as its own guidance, as the company and its clients had underestimated the normalisation effect after the pandemic.

Portfolio Activity and ESG

- Over Q1, the underweight position in Julius Baer was sold on continued worries around the company's compliance and risk management practices. The team also sold its remaining position in Bystronic as the weak order intake combined with the strong Swiss franc already led the company to reduce expectations for 2024 back in October 2023. Moreover, the recent surprise announcement of a CEO change is not expected to lead to a change in the group. The position in Roche Holding bearer shares was sold. While being among the larger weights in the SPI Extra, it is not a small and mid cap company. The team chose to buy an underweight position in 2023 as a risk mitigation exercise in a year where the portfolio was managed on a lower tracking error after the difficult performance of 2022. As markets are expected to be more driven by fundamentals than macro economic factors going forward, the team does no longer consider this necessary. Finally, the team completed the sale of Aluflexpack, on continued slowing sales momentum and high capital expenditure for the construction of a new factory. On the other hand, a position in LEM Holding, the global leader in current sensors and transducers active in electrical components for the ground transportation industry, was added. LEM has long been a high CFROI® (Cash Flow Return on Investment. Source: Credit Suisse HOLT) company actively contributing to the energy transition and climate change mitigation. The company usually trades at a high premium, justified by its strong and reliable operational

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performance and the team took advantage of the share price weakness after the company reduced its FY 2023/24 guidance. The team also participated in the IPO of Galderma Group. Galderma is a leading dermatology company with a science-based portfolio of brands and services that span the full spectrum of the self-care dermatology market through injectable aesthetics, dermatological skincare, and therapeutic dermatology. The small remaining position in Sonova, which had moved to the SMI in September 2022, was sold to finance this portfolio addition.

- At the end of March 2024, UBAM - Swiss Small and Mid-Cap Equity had an A ESG rating and an ESG Quality Score of 7.1 (based on MSCI ESG Research ratings), compared to an A rating and 7.0 score for the SPI Extra. The fund delivers a lower weighted average carbon intensity than its benchmark with 26.9 tons of CO2 emissions /$m sales vs 31.3 tons for the SPI Extra. The Swiss Small and Mid-Cap Equity portfolio also follows a strict exclusion policy. Finally, it does not hold any position identified as being in violation of international standards by both data providers MSCI ESG Manager and Sustainalytics.

Outlook

- Given the current market concentration levels particularly around US tech names, investors should factor in the risks of a negative market surprise linked to geopolitics and elections, interest rate moves or AI related results. We believe that investors should privilege diversified sources of performance for 2024, and Swiss equities are well positioned with a stable political and macro-economic backdrop, as well as a proactive central bank that has started the easing cycle.
- The team continues to see a favourable environment for Swiss companies in 2024, supported by the expected global GDP growth recovery and alleviating FX pressure on earnings after the SNB's move to cut rates. The global recovery in trade and manufacturing, as well as continued reshoring activity, could provide a tailwind for the Industrials sector. The Swiss small and mid-cap space – with close to 30% exposure to the Industrials sector – should be poised to benefit from this dynamic, supported by attractive valuation levels relative to the larger market cap segment. The Swiss Small and Mid Cap Equity strategy maintains its focus on visible levels of value creation, while also being exposed to attractive secular growth opportunities.

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