THE DRIVE YOU DEMAND

UBAM - GLOBAL EQUITY

Quarterly Comment | Q3 2019

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

Market Comment

- September marked the end of a mixed quarter for equity markets with the MSCI AC World finishing Q3 2019 flat at -0.03%. Major indices delivered positive performances over the quarter except Emerging Markets equities which were down -4.3%. Japanese and European equities posted the biggest gains with +3.3% and +2.6%, most of which recorded over the month of September; followed by Swiss equities with +2.1%, US equities +1.7%. The SPI Extra also posted gains with +1% over the quarter. Year to date, Swiss equities continue to outperform with +24.4% versus close to +16% for global equities.
- In September, major central banks steered further easing measures following a second setback in equity markets that came in August after that of May. Major economies progressed into late cycle stages with a synchronized deceleration in industrial production and stabilising inflation in labor and commodities markets. The US Federal Reserve cut interest rates by 25bps in mid-September for the second time in 2019, leaving the door open for another cut if needed before the end of the year. This came after the ECB also cut its key interest rate down to -0.5% with plans to restart quantitative easing in November. Early September, despite a strong Swiss Franc, the Swiss National Bank kept rates unchanged at -0.75% while reiterating its willingness to intervene in the FX market as necessary.
- September was notably marked by a sector/style rotation into oversold value names that proved to be short lived as it was not supported by EPS growth expectations. In fact, cyclical sectors, commodity related and financials, posted the biggest negative revisions for 2019. Despite the steady decline of global growth expectations for 2019 to low single digit (2% for global equities in 2019 versus 10% for 2020), valuation levels remained around long term averages of 15x. Coupled with a 3% dividend yield, this suggests expected returns of 5-6% for global equities on unchanged multiple, despite the huge PE compression that occurred in Q4 2018
- While defensive sectors of the MSCI AC World delivered strong performance over the quarter with Utilities and Consumer Staples up +5.4% and +3.5% respectively, other cyclical sectors were lagging with Energy down -5.5% and Materials -4.6%. YTD all sectors of the MSCI AC World are still in positive territory with the index up more than 16%. As stated previously and despite short lived cyclical rotations, defensive and quality sectors are expected to deliver strong relative performance in times of sideways moving markets.

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 returned -0.65% in gross performance at the end of the third quarter of 2019 versus a flat MSCI AC World at -0.03%. Year to date, the fund is up +22.9% with +6.7% in excess gross return.
- Over the quarter, stock selection was the biggest detractor of relative return with -36bps mainly from the Health Care sector. Stock selection in Utilities added +36bps to relative performance. Sector allocation was a detractor with -13bps mainly due to the underweight in Consumer Staples. Currency effect was also slightly negative with -13bps due to the portfolio's EUR overweight.
- In terms of individual names, the exposure to SolarEdge Technology and the overweights in NextEra and Home Depot were the biggest contributors to performance (+71bps, +34bps and +21bps respectively). SolarEdge was up 34% over the quarter after reporting solid EPS and revenue growth for Q2 19, exceeding analysts' expectations. The company also guided for Q3 revenues above market forecasts. NextEra Energy reported positive Q2 results beating estimates and maintained guidance for 2019-2022; the share price appreciated 14% over the period. Home Depot was up 12% as Q2 results came in better than investors had feared in a challenging environment for home improvement. Reported revenues came below consensus and despite lowering full year sales guidance, EPS guidance was maintained as higher margins are expected to offset some of the revenue weakness.
- The biggest detractors over the period were the exposure to Keywords, and the overweight in BHP and Rio Tinto (-30bps, -27bps and -25bps respectively). Keyword's share price collapsed by -39% after reporting strong H1 revenues but lower profit margins on higher costs as the company continued to expand capacity. The company guided for slower revenue growth for H2 2019 but with higher margins. Despite reporting positive results both BHP and Rio Tinto lost -13% over the quarter as iron ore prices came under pressure after a six month rally on the back of US-China trade war concerns.

Portfolio Activity

- During the month of July, the team decided to sell SS&C Technologies on the back of lowered guidance on deal slippage and a weaker market environment, which may persist and cloud the path to re-accelerating organic growth. A position was initiated again in Facebook given its resilient revenue growth despite pressures from data regulation. The team finds a significant CFROI upside on stable margins and strong growth prospects.
- In August, the team sold its position in Occidental Petroleum and EOG Resources given the deteriorating oil price outlook and the ongoing EPS downgrades for the energy sector versus very high expectations for 2020 earnings.
- In September, the team closed its position in Johnson & Johnson on rising risks related to the opioid litigation. A new position was initiated in Merck & Co as near term growth prospects are expected to improve the company's CFROI from 8% to 12% on better margins. The team also bought a new position in Veeva Systems, a software and data company servicing the healthcare sector with CFROI levels around 15% and more than 20% revenue growth. On September 18th, TSS, a position in the fund, was acquired by Global Payments.

Outlook

- After a flat third quarter, the team expects global equities to continue moving sideways for the rest of the year, with volatility swings coupled with geopolitical developments as trade remains a major topic. Despite downside risks on the political front and trade developments, consumer confidence is still resilient on stable inflation and labor conditions. An active management approach could offer equity investors a diversified exposure to proven high quality and growth names without the need to time style factors in this late cycle phase. The portfolio has been further adjusted to reflect a defensive positioning.

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