UBAM - BELL GLOBAL SMID CAP EQUITY

Quarterly Comment

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

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Market Comment

- Despite the relief recorded over the month of March, global equity markets ended the first quarter of the year in the red, with the MSCI AC World Index down -5.4%. US equities lost -4.9% over the quarter, followed by European equities with -5.5% and Emerging Markets equities with -6.3%. The beginning of the year was marked by sharp profit taking action on good performing names over 2021, with a rotation into value names and market segments. The Russia / Ukraine conflict added another layer of volatility in February, building up concerns over global food and energy prices and therefore persistently higher levels of inflation.
- Relative to other investment styles, Value was the best performing style YTD; however, it saw a reversal of trend and underperformed the market since the start of the Russia / Ukraine war, as investors sought more defensive positioning. Momentum and Quality were leading styles since February 24th.
- While the US labour market data could be seen as an overheating signal coupled with CPI inflation at 7.5%, US real GDP is expected to grow a solid 3% for 2022, and ISM is still printing at high levels, 57 for end of March. The Eurozone manufacturing PMI has also declined, but is still at high levels at 56.5, reflecting worries about demand and trade disruption due to the geopolitical situation.
- In line with expectations, the Fed raised key interest rates by 25bps, for the first time since 2018, with six remaining hikes projected for the year. The ECB has revised down its growth outlook for 2022 from 4.2% to 3.7% and revised up its inflation expectations from 3.2% to 5.1% in 2022. Interest rates were kept unchanged whereas a more hawkish tone was adjusted on asset purchases. The higher inflationary environment remains nevertheless coupled with sustained demand levels. This continues to provide a constructive environment for companies which can pass on higher commodity prices and labour costs to customers.
- Looking at small and mid-caps ('SMID') more specifically, the MSCI World SMID Cap Index was down -6.7% over Q1. Energy, Utilities and Materials were the best contributing sectors to the performance; on the other hand, Consumer Discretionary, IT and Industrials were the worst detractors.
- We believe earnings recovery still has a long way to play out in the SMID cap arena. 2022 should see EPS grow a further 19% from 2021 levels, vs. 13% for the MSCI Growth Index for instance (data as of March-end). Moreover, global SMID cap valuations remain attractive against a backdrop of rising valuation risk, with the MSCI World SMID Cap Index trading at a P/E of 16.5x at the end of March (on a 12-month forward basis), which represents a 38% discount to the MSCI World Growth Index and a 7% discount to the MSCI World Index.
- For the future, we remain confident about the potential of Quality companies, particularly in the SMID cap segment and thanks to their pricing power in a highly inflationary environment. In addition, their low leverage balance sheets should enable them to withstand rising interest rates better. UBAM - Bell Global SMID Cap Equity offers this "quality at a reasonable price" potential throughout this new cycle.

Performance Review

- UBAM - Bell Global SMID Cap Equity had a challenging 1st quarter of the year, returning -10.76% (Class IC USD, net of fees) and underperforming the MSCI World SMID Cap Index by 4%. Since inception in February 2021, the Fund has returned +8.26% (Class IC USD, net of fees), representing a 6% excess return versus the benchmark over the period.
- After an exceptional 2021, investor sentiment shifted, chasing returns in the energy sector and other areas of perceived ‘value’ in utilities and telecoms. This contributed to the underperformance of quality stocks during the first three months of the year. Using the MSCI World Quality index as a proxy for quality, the style has underperformed by around 3.5% year to date. These sharp swings in sentiment are often short lived, so we are confident in the outlook for our quality biased portfolio for the remainder of 2022.
- The underperformance in Q1 was primarily due to the lack of holdings in Energy (no allocation, 4% underweight) and Utilities (no allocation, 4% underweight). The overall allocation effect caused around 75% of the underperformance, with the remainder being stock selection, where various companies that had performed strongly in 2021 pulled back during the period.
- The position that contributed the most to portfolio returns in the first quarter was Kroger, which rallied 26% (+49bps contribution), after reporting strong results in early March and also due to its attractive valuation, beginning the year with a P/E ratio of 13x.
- IT security company Check Point Software (+43bps contribution) also rallied materially as they are expected to be a major beneficiary of increased spending on security due to the increasing frequency of cyber-attacks on governments and corporations around the world. Order backlog is improving after the company implemented changes to improve their ‘go-to-market’ strategy. The investment team has spoken to the company recently, where they highlighted that customers are allocating larger budgets to protect customer data and privacy. The valuation remains attractive at 19x P/E, especially considering the improving outlook.
- Other strong contributors included core banking software provider Jack Henry & Associates (+42bps contribution), which has also seen improving business conditions. The other two significant contributors both represent excellent value: US pharmaceutical distributor AmerisourceBergen (+36bps contribution) and Canadian telco Rogers Communications (+32bps contribution).
- The biggest detractor during the quarter was US based Fortune Brands Home & Security, which fell 31% (-97bps contribution). Their revenue is growing at around 6.5%; however, inflation, labour shortages and logistics costs are weighing on profitability forcing them to increase inventory levels to meet customer demand. There is some near-term earnings uncertainty, but the stock looks oversold and the valuation is very low at around 12x P/E, so the investment team has decided to add to the position.
- Other detractors included auto and bike suspension manufacturer Fox Factory (-79bps contribution), as well as drinkware and cooler maker Yeti Holdings (-72bps contribution). Both companies performed strongly last year but pulled back due to near term demand uncertainty as we look ahead.
- In terms of ESG credentials, the UBAM - Bell Global SMID Cap Equity portfolio was rated AAA by MSCI ESG Research at the end of March. Its 9.4 Quality Score represented a 33% excess to that of the MSCI World SMID Cap Index at 7.1. Looking at environmental risk more specifically, our strategy was showing 88% less carbon risk than its benchmark at the end of the quarter (in t CO_2e/USD million sales).

Portfolio Activity

- The portfolio remained relatively fully invested during the quarter, ending the period with just under 1% in cash. The drawdown seen in some stocks provided a good opportunity to reinvest, plus new names were added to the portfolio.
- From a trading perspective, two names were sold since they hit their price target, but there was less opportunity to trim names that had performed strongly. Cash was redeployed into various names that were oversold and represent compelling value, as well as into buying new positions in Nihon M&A, Masimo and Veeva Systems. The characteristics of the portfolio remained stable, and the focus was on maintaining earnings predictability and resilience in underlying companies.
- The outcome of these trades at a sector level resulted in increasing the Industrials exposure to 22% (2% higher vs. the end of Q4) purely by adding to existing names. Exposure to Consumer Staples was reduced further, now at 3% (2% lower) after the sale of Hershey which rallied strongly and due to ongoing concerns around inflation. In terms of earnings visibility balanced with attractive valuations, there is better opportunity in some health care and technology names.
- To highlight Masimo in more detail, they are a global leader in non-invasive patient monitoring and sensor technologies within hospitals. The company has a strong long-term track record of profitable earnings growth under CEO/Founder, Joe Kiani. The share price pulled back significantly in February after Masimo announced an acquisition which will help the company advance their strategy of connected monitoring across both the hospital and home setting. While this deal creates some near-term uncertainty, the investment team believes the long-term outlook remains positive and the current share price has presented a good opportunity to enter this high-quality name.
- In addition to Hershey being sold during the period, health care IT services company Cerner was also exited after it rallied over 30% when Oracle announced their intention to acquire the company.
- Key names that were reinforced included Partners Group, Zebra Technologies, Croda International and Ritchie Bros. The larger trims included Church & Dwight, Deutsche Boerse and AmerisourceBergen, which all performed well.
- From a sector allocation perspective, the most preferred sectors remain Information Technology (24% allocation), which increased over the quarter. With new names in Industrials (22%), it is now the second most favoured sector. Health Care (14%) and Consumer Discretionary (13%) also remain significant allocations and are reflective of where the investment team finds the highest quality companies.
- In terms of least preferred sectors, the largest underweights remain Real Estate (8% underweight) and Financials (7% underweight). The portfolio continues to have no exposure to the Energy sector (4% underweight) or Utilities sector (4% underweight).
- From a regional/country perspective, the largest allocation remained to North America with the US at 48% and Canada at 10%. The allocation to Europe remained diversified with the largest allocations being 9% to Denmark and 8% to the UK. The Asia-Pacific region is a smaller part of the benchmark; however, the portfolio underweight reduced with exposure currently around 4%.
- At the end of March, the portfolio's top 5 positions were Ritchie Bros. Auctioneers (3.1%), Booz Allen Hamilton (3.0%), CGI Inc. (2.8%), Electronic Arts (2.8%) and ICON (2.7%).

Outlook

- We are at a market juxtaposition with rising interest rates and the removal of stimulus happening as economic growth sharply decelerates. Turning points of an economic cycle or major changes to fiscal and monetary policy often result in a more volatile equity market environment, which provides many opportunities for active stock pickers with a disciplined investment approach and good judgement.
- Although there are economic uncertainties, the 19% forecast profit growth for 2022 of the MSCI SMID Cap index remains very strong. Additionally, the P/E valuation of the benchmark is attractive trading at a 7% discount to the MSCI World Index versus an average premium of above 12% over the last decade.
- From a style perspective and over prior cycles of rising interest rates, the investment team has experienced sharp changes in market behaviour such as chasing poor quality laggards. However, these conditions do not often persist as investors return to buying high-quality stocks with strong fundamentals that can offset the headwinds of an inflationary environment.
- Companies in the portfolio have excellent pricing power, predictable earnings and low levels of debt with a good overall valuation underpinning; therefore, the team is confident that the portfolio is well placed going forward.

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