

UBAM (CH) – SWISS EQUITY

Quarterly Comment

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Market Comment

- In Q3, all major equity markets posted positive returns, though with a downturn in September for most of them. The MSCI AC World finished up +8.1%. At regional level, Emerging equities were up +9.6%, US equities +8.9%, Japanese equities +5.2%, and European Equities +0.1%. As for Swiss equities, the SPI was up +2.3% and the SPI Extra ended Q3 2020 at +6.4%. YTD, the SPI and the SPI Extra have returned -0.9% and -0.7% respectively, whereas the MSCI AC World was up +1.4%.
- Economic activity continued its reopening recovery, but with fading momentum at the end of the quarter, pointing towards a still positive but slower growth pace in Q4. In the US, the manufacturing sector is in good shape with the PMI at 53.5, but in September the services sector activity declined for the first time since April from 55 to 54.6. The same happened in Europe with an increased divergence between a good momentum in the manufacturing sector and a negative sentiment in the services sector, impacted by renewed social distancing measures and constraints on hospitality.
- At the end of the quarter, the US continued to show positive earnings momentum across all sectors, whereas the picture was more mixed elsewhere. Furthermore, except for Materials, regional disparities across sectors were significant. Among the major markets, expected earnings growth rates for 2020 range from +0% for China to -39% for both the UK and eurozone, with the US roughly in the middle of the range (-16%). A sharp earnings rebound is anticipated in all major regions next year, notably for the eurozone (+55%). Regarding the major valuation metrics for global equities, the 12m forward PE fell to 19x after having exceeded 20x during the summer, the price-to-book ratio remained at 113% of its 5-year average while the 12m fwd ROE increased slightly to 90% of its longer term average.
- Switzerland's KOF indicator continued its rebound in September from 110.2 to 113.8 and now exceeds the highs seen in 2017. Unemployment continued to increase slightly over the month, but the unemployment rate remained stable. The Swiss GDP is now expected to contract by 5% this year, a drop smaller than that expected in other countries.
- Over the third quarter of 2020, most sectors contributed positively to the SPI's performance with Consumer Staples, Industrials and Materials adding the most while Health Care and Financials detracted. In terms of single names, the best contributors were Nestlé, Sika and Lonza, while Roche, Novartis and UBS detracted the most.

Performance Review

- Over Q3 2020, UBAM (CH) - Swiss Equity delivered +3.3% in gross performance versus +2.3% for the SPI. YTD, the fund returned +1.7% or +2.5% in gross excess return over the benchmark. Over Q3, the outperformance came from stock selection, contributing +1.2% to excess returns, while sector allocation detracted -0.2%. Stock selection in the Financial and Healthcare sectors was particularly positive, with a contribution of +58bps and +47bps respectively. The Materials sector also contributed very positively thanks to successful stock picking and its overweight in the portfolio given the strong performance of the sector over the quarter.
- In terms of individual names, the best contributors over the quarter were the overweights in Lonza, Sika and Givaudan (+32bps, +30bps and +25bps respectively). Lonza continued to enjoy positive momentum over the month of July as several analysts upgraded their numbers after the strong H1 results. The stock stayed flat over August and September but still ended the quarter up +14%. Sika had an exceptional quarter with the stock price up more than +24%. The company posted good H1 results and confirmed its 2023 targets ahead of a well-received capital markets day at the end of the quarter. Givaudan was up more than +12% over the quarter, continuing its rally since the mid-March lows after delivering very solid Q2 results in July and a confident mid-term strategic update at the end of August.
- The biggest relative detractors over the quarter were the absence of exposure to ABB (-21bps), the overweight in Zur Rose (-17bps) and the underweight in Sonova (-15bps). ABB traded up ahead of its Q2 results at the end of July which did indeed beat across all levels. The stock managed to hold on to those gains and ended the quarter up +10%. Zur Rose, whose share price nearly tripled from the beginning of the year to its peak in mid-July, sold off after H1 results in August revealed a bigger than expected loss due to continued investments. The stock ended the quarter down -15%. Sonova started to trade up after the company issued an unscheduled trading update at the beginning of July highlighting a faster than expected recovery in the global hearing care market and an acceleration of its structural cost savings program. These positive trends were confirmed at another trading update shortly before the end of the quarter leading the stock to gain more than +23% over the period.

Portfolio Activity

- Over the month of July, a new position was initiated in Comet – a previously held name – whose leadership in x-ray tubes and matchboxes for the semiconductor industry allowed it to navigate Covid-19 more or less unscathed posting a year-on-year increase in sales and profits for the first half of 2020. The team also built a small position in HBM Healthcare Investments, a holding company that invests primarily into later-stage private companies active in the pharmaceutical and medtech industries.
- No major changes were done on the portfolio level over the month of August.
- Towards the end of September, the team bought a position in Sonova as the company significantly increased its guidance due to a faster than expected market recovery, successful internal growth and productivity initiatives as well as the promising launch of the next generation of their connected hearing devices.

Outlook

- As we head into the last quarter of the year, equity investors continue to face uncertainties around the Covid-19 pandemic and the outcome of the US elections. A re-election of Mr. Trump could increase pressure on global trade and the economy in a post-Covid recovery while deregulation and tax reductions could be a tailwind for equity markets. With a Biden win, the Trump corporate tax cut of 2017 could be at risk to be partially reversed, while we could see increased stimulus and spending on climate change mitigation as well as increased access to federally funded healthcare. A divided government could lead to gridlocks in tax and spending regulation and higher volatility would be expected for equity markets.
- The expected earnings decline this year (-10%) and recovery next year (+17%) are a lot more benign for Swiss equities than any other major equity market implying lower risk of downgrades to the 2021 estimates. In addition, the Swiss market usually trades at a premium to the MSCI AC World due to the superior value creation of Swiss companies. Currently, it only trades in line with global markets at 19x and at a significant discount to the US at close to 22x. Finally, while the Swiss market has significantly outperformed global markets during the peak of the Covid-crisis, it has slightly underperformed since lockdowns have started to ease. With potentially more volatility in the quarter ahead this could reverse providing yet another reason why this could be a good opportunity to build or increase an allocation to Swiss equities.

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