THE DRIVE YOU DEMAND

UBAM – AJO US EQUITY VALUE

Quarterly Comment | Q2 2019

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

Market Comment

- The S&P 500 N.R. finished the quarter in positive territories with +4.15% performance at the end of June. Growth has been in favour this quarter with +4.54%. Value delivered a positive performance as well over the same period with +3.65%. Small caps were underperforming larger capitalization, delivering +1.99% for the quarter. Sector wise, Financial with +6.99%, Information Technology with 5.49% and Material with 5.37% have been outstanding. Energy delivered the worst sector performance with -3.19%, followed by Health Care with +0.97% and Real Estate with +1.64%.

- The rally in risk assets continued at a good pace in April, and US equities hit new highs. Economic indicators were very volatile with some pleasant surprises: first-quarter GDP growth beating expectations in several countries. The US economy grew 3.2% in Q1, driven by an increase in inventories and lower imports. However, sentiment indicators in the manufacturing sector remained disappointing in April because of ongoing uncertainty about trade.

- In May, economic indicators were weakened in by renewed concerns about the trade conflict between the US and China, alongside fresh sanctions against Mexico. Manufacturing and services sentiment in the US slid back, reflecting the increased fears about barriers to trade and declining industrial activity.

- In June, the accommodative tone struck by the major central banks helped both risk assets and safe-haven assets. The G20 meeting saw a truce called between the United States and China and the resumption of trade negotiations. During the month, geopolitical tensions between Iran and the US were ratcheted up, while Mexico managed to avoid having extra tariffs imposed by the US in return for immigration controls. On the economic front, the United States saw industry sentiment continue to slide – a trend which began to spread to services. The uncertainty generated by the trade war triggered a fall in order books and a decline in job creation. Investment showed signs of weakness but consumer spending remained steady despite the deterioration in household confidence. Although inflation dipped under the 2% mark, the Fed did not cut its key rates, rather it floated the possibility of trimming them by 25 bps at some point over the summer.

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

- Q2 2019 has been a difficult environment for value investors as the index (Russell 1000 Value NR) achieved +3.65% Vs +4.54% for the growth index (Russell 1000 Growth NR).

- In this context the strategy underperformed its benchmark lagging by 37 basis points net of fees (I share class) against the Russell 1000 Value NR.

- The biggest contributor in the quarter was the stock selection within Information Technology that added 0.31% of out-performance. Financials (+22bps), Consumer discretionary (+19bps), Energy (+17pbs), Healthcare (+6bps) and Consumer staples (+3bps) were also positive contributors to this quarter performance.

- Intel Corp lost 10.31% during the quarter. The fund had only an allocation of 0.24% to this equity (Vs 1.69% for the benchmark). This underweight delivered an outperformance of 0.23%.

- The largest detractor in the quarter was the stock selection with materials that cost 31bps of underperformance. Stock picking in the following sectors had also a negative impact: Real Estate (-28bps), Utilities (-24bps), Communication Services (-22bps) and Industrials (-22bps).

Portfolio Activity

- The portfolio manager constructs the portfolio according to AJO's investment process relying on 4 pillars: Value, Management, Momentum and Sentiment. AJO focuses on well-managed companies with quality cash profits, relatively low market valuations, positive price and earnings momentum, and favourable market sentiment. The portfolio is optimised to diversify multi-faceted risks.

- The portfolio was rebalanced according to the multifactor model. As such ManpowerGroup, Ebay and Voya Financial were among the largest additions throughout the quarter. The largest deletions were Bank of America, Microsoft and S&P Global.

Outlook

- In the US, positive fundamentals and labour market dynamics should support consumption, while net trade and capex should remain subdued. Weakening business sentiment on Q2 points to downside risks to capex and potentially employment if visibility is not restored to the trade and industrial outlooks.

- Global activity is clearly at a pivot: if the trade war intensifies, recession risks would increase and the economic cycle might derail. If concerns ease and business confidence recovers, the economic cycle should prolong, further benefiting from the recent renewed support from monetary policy.

- The latest Trump-Xi meeting has relaunched trade negotiations but global risks remain. After China, concerns could increase on Europe as US-Europe trade appears unbalanced. Our base case scenario favours a prolonged truce or partial agreement between the US and other trade partners, but tail risks of protectionism remain high. In anticipation of weakening global demand, exports and industrial activity, central banks have eased their stance and fiscal policy could also be used as a buffer.

- The Fed should cut rates in the summer, favouring an “insurance policy” as downside risks weigh on activity. The ECB has promised to relax its policy further, via rate cuts or renewed purchases of bonds if the scenario continues to deteriorate.

- In the US, new proposals for reduced capital gains taxes are emerging in parallel with the debate around infrastructure spending.

- The US reporting season is already around the corner. While global growth did slow over the quarter, the number of profit warnings has remained relatively low. Moreover, consensus expectations for only flat or negative earnings growth in the cyclical sectors, suggests that companies should again beat analysts’ estimates.

- The S&P 500 expected earnings growth rate for the full year has held steady (since April) at 3%. Following the slowdown in global growth and the lack of progress on the trade discussions, the downside risk to our “best-case scenario” to see 5-6% EPS growth in 2019 has arguably increased.

- Despite downside risks to earnings, valuations of most equity markets are back to the highest levels reached over the last 12 months, limiting scope for a strong upward move in equities.

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