UBAM (CH) - SWISS SMALL AND MID-CAP EQUITY

Quarterly Comment

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Market Comment

- In Q4, equity markets delivered mixed returns across regions. The MSCI AC World was down -0.9%: emerging market equities lost -7.9%, Swiss equities -4.7% and European equities -2.7%. On the other hand, Japanese equities were up +5.4%, and US equities +2.4%. The SPI Extra lost -5.0% over the quarter. In 2024, the MSCI AC World delivered 18.0% in performance compared to +6.2% for the overall Swiss Performance Index's (SPI) and +3.8% for the SPI Extra (total return in local currencies).
- In the US, economic data were mixed in December. While the Fed cut rates further by 25bps, the forward-looking statement for the interest rate policy turned more cautious than previously given solid growth, less downside risks from labour and potential higher future inflation. Business sentiment decreased slightly with the US manufacturing PMI index down from 49.7 to 49.4. The yearly trend in US CPI increased further from 2.6% to 2.7% at the end of November, while core inflation stayed stable at 3.3% y/y. US equities' EPS growth estimates remained at 10% for 2024 and 14% for 2025, with a broader contribution across sectors. The valuation premium of the US equity market versus the rest of the global equity market is still elevated, with the S&P 500 trading at 21.7x 12m FW PE versus 18.1x for the MSCI AC World.
- In the Eurozone the PMI manufacturing index remained in contraction territory at 45.1 in December, reflecting a continued drop in new orders that has pushed the production component to its lowest level in a year. Additionally, decreasing input costs indicate a potential reduction in inflationary pressures, which may enable manufacturers to lower selling prices for customers. The ECB cut rates further by 25bps as expected. The yearly inflation trend reaccelerated over the month of November, with the CPI up from 2.0% to 2.2% due to base effects on energy prices, while core inflation is stable at 2.7% y/y. European equities' EPS growth expectations remained stable at 2% for 2024 and 8% for 2025, coupled with a 13.5x 12m FW PE.
- In Switzerland, the KOF leading indicator dropped below the 100 mark in December, to 99.5, with sentiment for chemicals and pharma sectors declining. The SNB surprised the market, cutting rates by 50bps, given low inflation levels – at 0.6% y/y in December – and reiterating its willingness to intervene in the foreign exchange market to prevent appreciation pressure on the Swiss Franc. Unemployment remained stable at 2.6% in November, a low level compared to other regions. EPS growth expectations for Swiss equities remained stable and robust for 2024 and 2025, at 11% in both cases, with a 17.0x 12m forward PE.
- Over Q4 2024, Financials and Real Estate were the only sectors contributing positively to the SPI Extra, while Industrials, Healthcare and IT detracted the most. In terms of single names, Galderma, Julius Baer and Sandoz were the best individual contributors, while Straumann, VAT Group and Barry Callebaut were the largest detractors.

Performance Review

- UBAM (CH) - Swiss Small and Mid Cap Equity delivered -5.4% in gross performance in Q4 2024 versus -5.0% for the SPI Extra. Over the quarter, sector allocation, particulary the underweights in Real Estate and Financials, was the largest detractor from relative performance. On the other hand, stock selection, notably in IT, Healthcare and Consumer Staples, made a positive contribution. In 2024, the fund delivered +2.4% gross excess return compared to the SPI Extra.
- Over Q4, the largest individual contributors to relative performance were the overweight in Galderma, the absence of exposure to SoftwareOne and the overweight in Swissquote (+34bps, +28bps and +28bps respectively). Galderma's share price gained +28.0% as the company benefitted from supportive newsflow regarding its products and marketing strategy. SoftwareOne was down -59.2% on the back of a sharp profit warning and change of management. Swissquote was up +14.3% in part spurred by strong crypto currency performances.
- The main detractors from relative performance over the quarter were the absence of exposure to Julius Baer as well as the overweights in Ypsomed and Montana Aerospace (-66bps, -29bps and -25bps respectively). Julius Baer was up +15.2% after publishing a mixed trading statement that nevertheless supported bullish sentiment on the name. Ypsomed lost -20.5%. The stock corrected on the disappointing newsflow on the clinical pipeline of Novo Nordisk, which is widely seen as a potential customer. Montana Aerospace was down -29.3% in reaction to the disruptive industrial action affecting Boeing.

Portfolio Activity

- Over the first half of the quarter, the team sold the remaining exposure to Pierer Mobility, as newsflow continued to deteriorate. The position in Ascom was also sold on the back of continued lacklustre operational performance. Stadler Rail was sold following the company's guidance cut and suspension of mid-term targets in November. Finally, the position in Cicor Technologies was sold after the company's majority shareholder converted its mandatory convertible bond and was therefore legally obliged to submit a public takeover offer. On the other hand, a position in SGS, the largest global company specialized in inspection, verification, testing, and certification services, was initiated. After a period of disappointing performance, SGS has appointed a more ambitious and capable management team, selected by the Board of Directors and key shareholders, which is expected to drive profitable growth. Although the Cash Flow Return on Investment (CFROI, source: UBS HOLT) declined after 2015, it has now stabilized above 10%, and the new strategy focusing on both organic and external growth, along with improved efficiency, is projected to increase CFROI to around 15% in the coming years. While the company has historically traded at elevated levels, the anticipated improvements in growth and profitability in a defensive industry, coupled with high-quality management, justify accepting a premium for the stock. Additionally, the evolving political and regulatory landscape may favour the company, as it shifts towards more industry-driven regulations, enhancing its competitive position. Overall, SGS is expected to contribute defensively to the portfolio. It was amongst others financed by the reduction of positions in Accelleron and Swissquote, after a strong performance over the year, or Lindt & Spruengli. The team also initiated a position in Kuros Biosciences after the company turned profitable for the first time. It was then increased over the quarter.

All performance figures are given gross of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Outlook

- The outlook for global equities is constructive for 2025, supported by ca. 12% expected EPS growth for the MSCI AC World. The US election could bring improved business and consumer confidence, a consolidation of the budget deficit (government efficiency) and increased domestic activity. However, uncertainties remain about the path of inflation, tariffs, the further direction of low European growth and the risk of more erratic politics.
- In this context, the Swiss equity market is poised to benefit from Switzerland's political and economic stability as well as robust macroeconomic indicators, including low inflation levels. Swiss companies, with their geographically diversified revenue streams, are less vulnerable to economic fluctuations in specific countries. Furthermore, the US is now Switzerland’s largest individual export market, which should be beneficial given the country’s economic outlook. Additionally, the willingness of the SNB to intervene in the foreign exchange market to mitigate any significant appreciation of the Swiss Franc, leading to a more stable currency environment, could further support the Swiss equity market. EPS growth expectations for Swiss equities are robust for 2025, driven by contributions from various sectors, notably from Industrials and Healthcare, where the Swiss small- and mid-cap market has significant exposure. Moreover, the segment is currently supported by appealing valuation levels compared to larger market-cap stocks.
- The Swiss Small and Mid Cap Equity strategy remains focused on selecting quality companies demonstrating visible levels of value creation, while avoiding heavily cyclical and more volatile names. Additionally, it should benefit from its exposure to attractive secular growth opportunities across sectors.

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