Europe Small Cap Strategy

Pricing power should prove an important feature in this context where raw materials are once again becoming a strategic issue

- Small caps underperformed large caps in Europe in February
- The strategy lagged over the month although it held up well as volatility increased with the Russian-Ukrainian conflict
- We initiated several positions over the month such as Signify (leader in led lighting) and Technoprobe (IPO in the semiconductor testing phase)

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What's happening?

While the COVID-19 pandemic chapter seemed to be closing with a normalization of monetary and macroeconomic trajectories, Russia's invasion of Ukraine at the end of the month kept investors on edge. If Western diplomacy failed to prevent this tour de force by the Russian President, it nevertheless reacted with sanctions aimed at stifling the country economically. The geopolitical balance is being rewritten in a context where raw materials are once again becoming strategic issues. Europe, demilitarized, largely dependent on Russian gas, appears weakened.

In this context, in terms of yield curve movements, February was a tale of two halves. The US 10-year rate began by crossing the 2% threshold upwards, a level not seen since the summer of 2019. The Russian-Ukrainian conflict put an end to this movement, amid rising concerns about the growth outlook. The US yield curve flattened. In Europe, the movements were comparable, with the euro curve steepening however. Volatility indices soared, while oil prices reached $100 a barrel at the end of the month.

Equities fell everywhere in the world, notably in Europe. The rotation from the "growth" style to the "value" style observed in January eased. In terms of sector, energy, materials and consumer staples outperformed the broader market, while healthcare, IT and consumer discretionary significantly underperformed. As for geographic performance, Japan and Emerging Markets tended to be more resilient, while North American, European and UK equities underperformed.

Strategy positioning and performance

In February, the strategy lagged slightly the Stoxx Small 200 index. The allocation effect was neutral whilst our stock selection weighed slightly in the technology, healthcare and energy sectors.

Positive contributors over the month include Clipper Logistics, Nel, Neoen, Emmi and Edenred.

The British logistic company, Clipper Logistics, specialized in the management of product returns, has been the subject of a purchase offer from the American GXO Logistics, both in cash and securities (premium of about 15% on the price before announcement).

In the area of energy transition, Nel, a Norwegian producer of electrolysers, and Neoen, a 100% renewable French utilities, benefited at the end of the month from the prospect of an accelerating Europe's energy transition to reduce dependence on fossil fuels producing countries that may be politically unstable like Russia.

Emmi, a Swiss food group, was also a safe haven in the quality rotation that began at the opening of the conflict between Russia and Ukraine. The same goes for Edenred, the specialist in prepaid vouchers (restaurant tickets, petrol) which also benefited from the publication of annual results that exceeded expectations.

In contrast, Technip Energies, a French engineering company and leader in the field of liquefied natural gas (LNG) was heavily penalized by its exposure to Russia, representing about 20% of its order book at the end of 2021. The market sanction does not take into account the upgrade of the company's earnings prospects outside Russia as Technip Energies should benefit from the revival of LNG projects outside Russia and the acceleration of the energy transition (through its exposure to green hydrogen in particular) to ensure Europe's energy independence.

Within healthcare, Evotec, which provides research services for pharmaceutical companies, suffered from the shutdown of a molecule whilst the Swedish medtech company Addlife fell sharply in February penalized by the publication of disappointing quarterly figures and the announcement of the departure of its CEO which has been decisive in the construction of the group.

Finally, the Swedish property developer JM AB has been penalized by fears of the impact of credit conditions could have on its business whilst the online drug sales platform Zur Rose has suffered from the announcement by the German Ministry of Health of the postponement of the launch of the e-prescription without specifying a new date.

Outlook and portfolio changes

The Russian Ukraine conflict is significantly changing the 2022 outlook. Investors are turning more cautious as a result as the rise in commodity prices, the economic sanctions and negative sentiment will affect economic growth especially in Europe. The leadership profile of our companies combined with their pricing power should prove to be a strong feature in this context where input prices are rising and the economic cycle may slow. Past reporting seasons have however demonstrated strong resilience in earnings growth for many of the companies owned in the portfolio.

In terms of movements, we closed the position in BIC (disposable consumer products) and took profits on Bankinter (Spanish Financial Services) and Clipper Logistics. We have initiated a line in Signify, world leader in LED lighting, which must take advantage of European and American renovation plans to reduce the energy footprint of buildings.

We have created a position in Rational, which offers multifunction ovens to the restaurant and hotel sector in particular, and has a record order book at the dawn of the reopening of economies. We also introduced Trustpilot, a free review platform for businesses and consumers and participated in the IPO of the Italian company Technoprobe, which offers chip testing solutions.

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No assurance can be given that the Europe Small Cap Strategy will be successful. Investors can lose some or all of their capital invested. The Europe Small Cap strategy is subject to risks including; Equity; Investments in small and micro capitalisation universe; Investments in specific countries or geographical zones.