Europe Small Cap Strategy

European small caps ended 2021 on a positive note

- Rates sensitive industries were particularly in favor this month
- The strategy slightly underperformed the benchmark
- We have initiated a new position in Nel, a Norwegian manufacturer of electrolysers for hydrogen production

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What's happening?

The uncertainty initially caused by the Omicron variant last month finally turned to wild optimism, giving way to the traditional end-of-year rally. Most financial markets ended the month higher and US stock indices have even given themselves the luxury of setting new all-time highs. The possible impacts of a rapid spread of the virus on production levels, already largely hampered by previous waves of lockdowns, did not unduly worry investors, reassured by the lesser dangerousness of this new variant spreading within a population now widely vaccinated.

On the monetary policy front, inflation is no longer being qualified as transitory by central banks. The yield curves continued to rise, with the US 10-year yield now above 1.50%. In Europe, this increase was even more pronounced, with the 10-year euro rate approaching 0. The Euro appreciated against the Dollar but depreciated against the British Pound. The Yen depreciated against the Euro and the Dollar. Oil prices settled comfortably above the $70 threshold. Volatility indices plunged again.

The style arbitrage between « growth » and « value » stocks was still topical in this end of year in favour of the latter. The financial sector was driven by changes in yield curves. Cyclical stocks such as materials, energy, construction and industry, fared better than the more defensive stocks in healthcare or consumer staples. The IT sector has also underperformed the market.

Strategy positioning and performance

In December, the Europe Small Cap strategy slightly underperformed its Stoxx Small 200 index, mainly penalized by its overweight in the technology sector whilst stock selection contributed positively overall.

Positive contributors include Allfunds, Hill & Smith and Faurecia. On the other hand, Zur Rose, Soitec and Garo contributed negatively to the portfolio's performance over the month.

The fund distribution platform Allfunds ended at levels close to its highs, driven by its continuous growth in revenue and assets under administration. Allfunds' assets under administration have indeed progressed from EUR 200 billion to EUR 1400 billion in the space of 20 years through a combination of acquisition and organic growth.

The stock of the British company Hill & Smith, which produces barriers and other road safety equipment, recovered strongly in December after its downward reaction to its earnings publication in November. Its exposure to the construction of bridges and roads, particularly in the US (40% of sales), and its ability to offset the increase in raw material and labour costs by price increases has been appreciated by investors and should support the company growth in 2022. Stocks of the French automotive supplier Faurecia were also sought after investors anticipate a normalization of global car production in 2022 and after the new reset on its 2021 results announced in November.

On the other hand, Zur Rose, the online distributor of pharmaceutical products online primarily in Switzerland and Germany, weighed on performance. A few months ago, its management team revised downwards its guidance for the full year notably due to a delay in the test phase of the e-prescription in Germany. In December, the cancellation of the e-prescription introduction (initially scheduled on 1-Jan-2022) took another toll on the shares.

In the technology sector, stocks like Soitec and Comet, have been subject to profit taking after a very strong performance run.

Outlook and portfolio changes

The reporting season has demonstrated strong resilience in earnings growth for many of the companies owned in the portfolio. Concerns around China slowdown, value chain disruption mainly in electronic components, inflation in raw material and wages have not materially hammered profitability or growth profile. The leadership profile of our companies combined with the pricing power proved to be a strong feature in this inflationary environment. Tapering environment in which we are entering could lead to short term volatility. The small and mid-cap universe is at the heart of innovation and provides solution in a world which is deemed to be more sustainable.

In terms of movements, we took profits on Avanza, JM AB, Croda, Future, Comet, Evotec and NetCompany, and lightened the position in Zur Rose. We have initiated a new line in Nel, a Norwegian manufacturer of electrolysers, and have strengthened the positions in Faurecia, SSP, Allfunds and Fabege.

Stock shown for illustrative purposes only and should not be considered as advice or a recommendation for an investment strategy.

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.