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Next Generation Strategy

Markets wave off Omicron concerns

- Investors showed optimism in this end of year
- The strategy underperformed over the month
- We took profits on our semiconductor equipment stocks (Lasertec and Comet)

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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.

In terms of sector, utilities, real estate and materials outperformed the broader market, while communication services and healthcare underperformed.

As for geographic performance, Japan and Emerging Markets were notable laggards, while the UK and Europe tended to outperform.

Strategy positioning and performance

The Framlington Next Generation strategy underperformed its comparative index in a market environment favouring stocks sensitive to rates, and penalising those with long duration.

The top contributors over the month included Icon, Lasertec and Novanta. Icon, a contract research organization (CRO), performed well as market participants continued to grasp the benefits of its combination with PRA Health Sciences, another global CRO. Besides offering a sound rationale and attractive potential synergies, their combination will also strengthen their decentralised clinical trial solutions as clients are increasingly demanding virtual strategies and remote monitoring capabilities from their providers.

Lasertec, a Japanese manufacturer of mask inspection systems, which are notably used by semiconductor chip manufacturers to inspect photomasks used in the lithography process, reached new highs during the month. While the global demand for semiconductor manufacturing equipment remains buoyant amid persisting capacity constraints, Lasertec also benefits from the structural investments happening at the leading nodes allowing the Moore Law to continue.

Finally, Novanta, a US-based manufacturer of precision photonics and motion control components with exposure to the healthcare and advanced industrial technology markets, performed well over December. In the absence of fundamental news, investors continued to find comfort around the recent strength of its Medical division, which is benefiting from the strong demand for surgical robotics and DNA sequencing, while its Advanced Industrial business is also experiencing solid growth.

Less positively, Zur Rose, Everbridge and Nihon M&A Center were among the worst relative performers in December. Zur Rose distributes pharmaceutical products online primarily in Switzerland and Germany. 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.

Everbridge, a cloud-based software provider focused on population alerting solutions for public clients as well as on critical event management software for enterprise customers, saw its shares collapse during the month. Its CEO surprisingly announced his resignation, while the growth outlook for 2022 was also reduced. Its reappearance at another software firm, although relatively reassuring, did not provide significant support for the stock as uncertainty still prevails for 2022.

Finally, Nihon M&A Center, a Japanese M&A boutique mostly catering to entrepreneurs wishing to hand over their company, also faced intense selling pressures as it announced that it had found potential accounting irregularities. The group recognizes sales every quarter based on factors such as M&A transactions closed during the period, but an internal review revealed some potential irregularities on this front. In order to clarify the facts, the company has decided to conduct an internal investigation with the cooperation of outside experts covering the last five years.

Outlook

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 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 portfolio activity, we took profits on JMDC, Lasertec and Comet, and reduced our

Quebecor holding. We continued to build our Switch position and increased our exposure to financials by initiating new positions in British reinsurance group Hiscox as well as in Signature Bank, a New-York-based full service commercial bank.

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