Global Small Cap Strategy

Continued dovish monetary policies supported risk assets

- September saw a significant rotation from the growth style into value
- AXA WF Global Small Cap fund underperformed its benchmark, the S&P Global Small Cap Total Return Net
- Stock selection detracted while sector allocation enhanced returns

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What's happening?

As widely expected, central banks made further rate cuts in September. The Fed, for a second time this year, reduced its key policy rate by 25 basis points, bringing it to the range of 1.75-2%, while the ECB reduced its rate by 10 basis points bringing it to -0.5%. The latter added this rate cut to an asset buyback program for which it did not specify the time horizon. Despite these dovish moves, the yield curves recovered. This massive new influx of cash has supported valuations of risky assets, allowing equity markets to rise further. European indices outperformed their US counterparts, filling their lag in performance since the beginning of the year. No news on the trade war front tarnished this renewed optimism. Uncertainty about the resolution of Brexit remains high. Nevertheless, newly appointed Prime Minister Boris Johnson weakened himself by his political maneuvers, as did the assumption of "no deal", thus strengthening sterling against the euro. The dollar was slightly appreciated against the euro. Despite the drone attacks on Saudi Aramco's facilities, temporarily depriving the world of substantial production, oil prices hardly changed in September. Lastly, volatility indices fell again.

The S&P Global Small Cap Index (total return, net, USD) was up in September (+1.5%), underperforming its large cap counterpart (+2.2%). Japanese and UK equities were sought after over the month, followed by Europe and North America while Emerging markets lagged somewhat. As for sector performance, cyclical sectors, such as industrials, financials, and energy tended to outperform defensive ones (e.g. healthcare and consumer staples). Finally, the month saw a significant rotation from the growth style into value.

Portfolio positioning and performance

In September, AXA WF Framlington Global Small Cap underperformed its comparative index, due to negative stock selection while sector allocation was helpful (mostly thanks to our overweight in financials). Despite a positive selection within the healthcare, materials and energy sectors, our stock picking in consumer discretionary more than offset this positive effect.

Within materials, BRAIN's shares soared on the back of a very encouraging third quarter print. The German player, which develops biotech compounds and microbial producer strains primarily for the cosmetics and food industries, posted a strong organic growth figure and improved profitability considerably over the period, while two important programs should see their first product deliveries in the coming months.

In the financial sector, Kemper performed well, as investors continued to praise its targeted strategy on the non-standard auto insurance market. With a focus on such a niche market and a strong brand recognition, Kemper faces a competition that is largely subscale, while the size of this market also limits interest from national insurers.

In the healthcare sector, US-based telemedicine specialist Teladoc also performed well, following an announcement by UnitedHealthcare that it would add Teladoc to its network as a Virtual Visit provider. Offering this solution more broadly to United's clients further validates the broader telehealth opportunity, highlighting significant potential savings for the industry.

In the energy sector, Core Labs, a provider of reservoir description and production enhancement services, rallied after having given way in August, while also benefiting from volatile oil prices.

In the consumer staples sector, Ain Holding, which operates a network of pharmacies in Japan, rallied following a reassuring quarterly print. Group revenues were ahead of market expectations, as pharmacies were strong enough to offset the weather-driven weakness in the cosmetics specialty store division.

In the technology sector, Pluralsight and Flir Systems regained some lost ground without any fundamental news intervening. However, we suffered from our exposure to Blackline, which was penalized by the shift towards low valuation stocks.

Similarly, in the communication services sector, New Work cost us, as the stock was likely avoided for its exposure to the German economy as well as for featuring a high valuation.

Finally, the rotation towards value stocks was particularly apparent and costly in the consumer discretionary sector. While Samsonite, which trades at a depressed valuation, rallied somewhat, Bright Horizons, Planet Fitness and Fox Factories were all penalized for their growth trait. The latter also suffered from share sales by its management team.

In terms of portfolio activity, we added to Teladoc, Exponent and A.O. Smith. On the other hand, we received the cash from Wessanen as we brought our shares to the offer.

Outlook

This coming quarter could see some volatility coming from a combination of earnings downgrades and a cautious approach from investors due to geopolitical uncertainties. At this stage, there is no sign of recession anxiety.

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