Europe Small Cap Strategy

Improved performance relative to large cap as market leadership broadens.

- A soft landing, stable-to-lower interest rates, positive GDP growth and an absence of systemic credit issues all support buoyant equity markets.
- Our strategy underperformed in March as the most "value" sectors such as the banking sector, energy, insurance, commodities or real estate performed best.
- We would expect our quality/ growth approach to serve us well as we move further into 2024. Small cap valuations are attractive, earnings are broadly resilient and expectations well grounded. Lower rates should sustain an expansion of multiples.

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What's happening?

Equity indices reached all-time highs during the month, both in the United States and in Europe and Japan, buoyed by strong macroeconomic news. U.S. growth has been revised upwards for the 4th quarter of 2023, driven by a significant inflation component, which is pushing the U.S. Federal Reserve to further delay its first rate cut. In Europe, central banks are also considering the best time to start monetary easing. Switzerland was the first to set the ball rolling by lowering its key interest rates by 25 basis points to 1.5%. The UK central bank seems ready to follow in the footsteps of its Swiss counterpart. As for the ECB, it has been slow to follow. On the other hand, Japan's central bank has put an end to a long period of monetary largesse, as the country has so far failed to break out of the deflationary spiral. This desynchronization reflects disparities in the positioning of countries on the economic cycle, which should be reflected in the stock market movements. For now, investors are celebrating and markets are rising. Companies, which have benefited greatly from the inflationary period, have maintained their margins despite falling volumes. They could therefore rise further if the recovery is confirmed. Strong balance sheets and exemplary cash generation give them a lot of flexibility in their capital allocation.

From a sector and style point of view, the most "value" sectors such as the banking sector, or those of energy, insurance, commodities or real estate performed the best in March. "Growth" or defensive sectors such as IT, telecoms and healthcare have lagged behind. It should be noted that small caps outperformed large caps.

The EUR/USD exchange rate has hardly changed. The yen continued to depreciate. The Swiss franc depreciated against the euro as a result of the above-mentioned rate cut. Volatility indices fell again. The barrel of crude oil has crossed the threshold of USD 80 upwards.

Strategy positioning and performance

The strategy underperformed its Stoxx Small 200 index by a significant margin over the month. For once, the allocation effect proved to be the most challenging this month, due to the portfolio's underweight in the energy sector and its over-representation in technology. Over the month, Spie, Scor, Neoen and Esker contributed positively to the fund's performance. On the other hand, Soitec, Technoprobe, Watches of Switzerland and Marshalls are among the main detractors.

Spie is a business services company for energy and communications infrastructure. The company reported strong full-year results, which exceeded expectations in both organic and margin growth. The strong cash generation of its business allows it to fuel its growth model through acquisitions. Its order book allows it to be reasonably optimistic for 2024.
Scor, the French reinsurance group, active in life and non-life reinsurance as well as in asset management benefited from stronger demand for the sector. Improving governance, a better-quality underwriting portfolio, a competitive environment more conducive to price increases and appropriate asset/liability management have all enabled the stock to bounce back, in a market context favourable to discounted financial stocks.
Neoen which produces and distributes energy from renewable sources (solar and wind) also rose on the back of rising energy prices and the cost of electricity has allowed the sector to rebound. In addition, the company announced that it may divest some of its mature Australian assets to fund its growth in other regions.
Esker, the French publisher of supplier invoice management and purchasing software, surprised positively on its 2023 annual results and its growth prospects in 2024. The group is currently benefiting from the implementation in France of a regulation requiring companies to adopt digital invoicing. Other countries such as Spain and Germany are expected to follow in France's footsteps offering additional opportunities for the group.

On the other hand, Soitec, which produces substrates for the semiconductor industry, hurt relative performance. Highly indexed to the mobile phone market, which does not yet show signs of a clear recovery, the group has issued a warning on its results for the year 2025 (fiscal year postponed to March), arguing that the first half of the year will be down sharply due to still substantial stocks at its foundry customers.
In the same sector, the Italian Technoprobe, which supplies test boards for electronic chips, has not escaped the turmoil in the semiconductor segment. However, the group published annual results in line with expectations and announced double-digit sales growth for the current year but indicated that the improvement would only be visible from the 2nd half of 2024, thanks to the expected recovery in demand in consumer products, and the group's operating leverage.
Weak news flow for demand for luxury products in March weighed on the stock of British watch distributor Rolex, Watches of Switzerland. The group itself had warned about its 2023 results, victim of lower demand in Great Britain at the end of the year and lower sales for the most high-end watches.
Finally, the British building materials group Marshalls had to revise downwards its 2024 earnings forecast. The turnaround in new construction and renovation, expected in the second half of 2024, is anticipated to be less pronounced than initially thought. Given its optimized production, Marshalls should benefit from the recovery in volumes as soon as it materializes.

Outlook and portfolio changes

In terms of movements made over the past month, we have reached our target allocation in Intercos, Interpump and Beijer Ref and initiated a new position in Bankinter. On the other hand, we reduced our positions in Axfood, Scor, Watches of Switzerland, Bank of Ireland, Arcadis, Befesa, Intertek, Krones, Rational, Hill & Smith, CTS Eventim, Truspilot, Ipsos, Demant and Fortnox, and closed the position in Victrex.

Expectations of a soft landing, stable-to-lower interest rates, positive GDP growth and an absence of systemic credit issues all support buoyant equity markets. Nevertheless, the disinflation momentum appears to have slowed, given the risks associated with Middle East conflicts and investors pared back expectations for rate cuts, until central banks are able to offer clearer guidance. Looking ahead, inflation drivers could diverge in key regions and monetary policy will have to adapt to such differences – indeed this process is underway in several important economies.

While the rise in markets has centred on large cap, we are positive on European smaller companies. Valuations are attractive, at the bottom of the range in some markets, earnings are broadly resilient and lower rates should sustain an expansion of multiples. In this context, we expect the selection of high-quality growth orientated companies to prove effective.

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.