

Market commentary, 4 October 2021

Dynamic small and mid-caps with good return potential

Fear and uncertainty regarding COVID variants and the negative effects they could have on the world economy have cast a shadow over market sentiment. What has that meant for small and mid-cap performance? Leaders in market niches – hidden champions – are less vulnerable to the global macro cycle and often generate dynamic growth thanks to their innovation and technology leadership, even in the face of stronger headwinds. This is one reason why small and mid-caps have outperformed both year to date and in recent weeks, regard-less of the uncertainty associated with the Delta variant.

Stock valuations may be at lofty levels in absolute terms, but that is justifiable in an environment of rock-bottom interest rates, accommodative monetary policy and excess liquidity. Huge government investments in infrastructure programs and clean energy are also a positive factor. P/E multiples in Europe have actually stopped climbing and are now receding as market gains have been outpaced by earnings growth and positive earnings revisions. This phenomena was again on display during the Q2 2021 reporting season.

Many companies reported significant positive earnings surprises and the consensus EPS estimate for 2021 has been revised 16% higher since January. Forward earnings estimates have climbed 26% since the beginning of the year, while stocks have advanced about 20%. This means valuation levels have declined by a full point despite the market gains and that the overall market has become less expensive. Going forward, identifying which companies are most likely to report positive earnings surprises will be more critical for performance than the general valuation re-rating.

With regard to investment styles, growth stocks have outpaced value stocks since April, which reflects the decline in bond yields. Yields have probably reached their low, so the performance of cyclicals and value stocks will likely level out during the remainder of the year. Sustained positive earnings momentum in the second half and a decline in Delta variant cases as immunization levels rise are potential performance triggers. The portfolio of the Bellevue Entrepreneur Europe Small Fund contains a mix of value (35%) and growth (65%) stocks that adequately captures diverse sources of alpha in the various investment styles to address the aforementioned uncertainty and constantly shifting scenarios. Astute stock picking remains the key factor for investment success though. In a recent portfolio transaction, we added French auto supplier Faurecia in the value segment after its compelling acquisition of Hella. We know and have strong confidence in the management teams of both companies and their ability to unlock the full synergies behind this deal. We continue to see considerable upside potential for small and mid-caps in general and for the Bellevue Entrepreneur Europe Small Fund in particular, which, with its sharp focus on quality, has delivered a return of 12.5% p.a. since its inception in 2011.

About the author:

Birgitte Olsen, CFA, Senior Portfolio Manager Equities Europe, joined Bellevue Asset Management in 2008 as a manager of European equity funds and institutional mandates. Prior to that she spent nine years at Generali Investments in Cologne, where she managed European equity portfolios. From 1997 to 1998, she was with Vontobel Asset Management in Zurich as a fund manager for the German and Scandinavian markets. Birgitte Olsen began her career in the financial sector in 1994 as a sell-side analyst at Bellevue Bank covering the insurance and pharmaceutical sectors. She earned a degree in finance and accounting from the University of St. Gallen in 1992.

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