HÉRENS QUALITY ASSET MANAGEMENT

2023 REVIEW

January 2024

INSIDE THIS ISSUE:

Navigating the Ups and Downs

HQAM

HERENS QUALITY ASSET MANAGEMENT

CEO message

Dear clients, investors, and readers,

Happy 2024! I wish you all the very best for the new year! "New year - new luck" as the popular saying goes. In the investment world, we take it to heart and reset the performance measurement to zero on January 1st. A few thoughts on the meaninglessness of this approach later. However, luck also suggests that something happens for which you are not directly responsible. And in this sense, luck (or misfortune) surrounds us every day - starting at birth, where luck determines which home or environment you are born into. If you think about what is happening in world politics at the moment, I believe that humanity will need more luck in 2024 than it has for a long time. For one thing, we have conflicts in our immediate geographical vicinity that could escalate at any time. It would be the best of luck for the millions of people directly affected if the armed conflict came to an end. But it does not take much for the situation to deteriorate further. There are also other trouble spots and political events, such as the US elections in November 2024, for which the scenario analyses do not look particularly encouraging and a large portion of luck will be needed to get through the year reasonably unscathed.

From an objective point of view, however, there are also plenty positive developments. Humanity has never been as well off financially, in terms of health and education, etc. as it is today. Unfortunately, many people do not see this or do not want to see it, feel disadvantaged and blame others for their "misfortune". Another saying - "Every man forges his own destiny" - fades into the background. If this basic idea is applied to investing, it certainly refers to craftsmanship, a systematic approach and honesty. This is essential in order to force luck to your side in the long term. However, if we look not only at the last year 2023, but the entire period since the start of the Covid crisis, we can certainly speak of a certain normalization. This refers to an adjustment to the new financial policy circumstances, in particular the higher interest rate level. It is true that the stock market in 2023 was anything but calm and in the final weeks of the year there was almost a sense of euphoria about the possible interest rate cuts in 2024. However, for various reasons, we were spared from the "doom and gloom" scenarios conjured up in many of last year's forecasts. One of the reasons is the more stable economic environment. Both Europe and the USA performed better than expected: Europe was able to avoid a general, deep recession and the US economy grew well above expectations thanks to an extremely strong labor market. Another reason was a clear "rebound effect". After 2022, when many high-quality and highly profitable business models, particularly in the technology sector, were heavily penalized due to the rise in interest rates, last year saw a revaluation and, thanks to the triumph of artificial intelligence, a veritable gold-rush mood in some cases.

Interest rates will undoubtedly continue to be a dominant topic in 2024. It will probably not play a decisive role whether central banks cut interest rates slightly or not. What is important is that the temporary peak has been reached. We will have to live with higher interest rates - and that is not a bad thing per se and is absolutely normal. With their low debt levels, high profitability and margin stability, quality companies are ideally positioned to successfully master these challenges.

With this in mind, let us look in the year ahead with confidence. I look forward to exchanging ideas with you in the new year.

With kind regards.
Diego Föllmi

AI Beats Forecasters

We hope everyone has enjoyed a nice rebound after the painful downside of 2022. The development of AI has helped out technology stocks, primarily the Magnificent 7 (Apple, Amazon, Alphabet, Nvidia, Meta Platforms, Microsoft, and Tesla), in regaining their ground. The weight of the top 7 stocks has reached over 25% of the S&P 500 Index total market cap, significantly influencing the index performance. The anticipation of rates decline next year has positively impacted growth stocks. The growth style clearly dominated this year, returning 46% in the USA, in stark contrast to value stocks, which only grew by 8%. Value stocks experienced additional pressure during a banking crisis in the spring and due to lower oil prices. It is worth noting that the difference in returns between value and growth styles was not as pronounced in European stock markets: 16.1% (Growth) vs. 15.6% (Value).

The quality style performed exceptionally well this year, outperforming market indices in all regions. The most outstanding portfolio was the Top 8, which returned 41%, surpassing its benchmark by more than 20%. Almost all companies in this portfolio, with the exception of one, outperformed their benchmark, MSCI World Index.

Despite an increase in investors' risk appetite observed across the markets, small caps were unable to keep pace with large caps in 2023. Both in Europe and the USA, they lagged behind the market.

Among the best-performing sectors in the US were Communication Services and IT. IT also performed excellently in Europe, followed by Industrials. The only decliners in the US were defensive sectors - Utilities, Energy, and Consumer Staples. Consumer Staples struggled in Europe as well. Health Care companies, with few exceptions like Novo Nordisk, were the worst performers in Europe last year.

FY 2023 was also characterized as the year of failed forecasting. Traders were mistaken regarding the market movement. It was unexpectedly positive. Macroeconomists and monetary policymakers were not correct regarding inflation and economic growth. The former was slowing down too fast, while the economy and consumer spending (primarily in the USA) remained resilient. The latest US inflation figures indicate that it has calmed down to 3.1%. This has provided a substantial boost to the stock market, giving rise to discussions about cutting rates next year.

The elevated demand for services and the integration of almost everything AI-powered is nothing short of remarkable, offering hope for a clear path for the market growth in the upcoming year.

	Quality*	Value	Growth	Small Cap	Market	Quality Top 8*
USA	36.8%	8.4%	46.5%	17.9%	26.5%	
EU	21.3%	15.6%	16.1%	12.7%	15.8%	
CH	8.3%	16.6%	-0.4%	5.6%	5.3%	
World	26.5%	7.7%	32.4%	11.8%	19.6%	44.9%

Fig.1 Performance (TR) 1H 2023 by regions based on MSCI regional indices (Currencies: USA – in USD, EU - in EUR, CH – in CHF, World – in EUR); * - Hérens Quality Portfolios

Corporate Excellence Insights Published in 2H 2023

Historical Buys & Sells: Our Main Learnings

Here we share the main conclusions of the past decision-making review, which is a part of the asset manager's routine. The results of previous reviews have improved our decision-making, thus making a positive contribution to the performance of our portfolios. As such, we systematically avoid investments in state-regulated sectors, in capital intensive businesses and companies undergoing turnaround or in the early stage of the restructuring process. Now, more than ever, we scrutinize historical margin development to understand its consistency over the cycles and pay even more attention to the quality of corporate governance.
https://hqam.ch/en/asset-managers-homework/

Investing for a green future

About 40% of global sustainable investing assets fall under ESG integration strategy, which considers how successfully a company manages its material sustainability factors as part of a holistic analysis of the business. ESG integration is therefore not about investing in companies that do good for the planet – it's about a careful assessment of risks and opportunities that company is exposed to from ESG perspective. Investors who wish to ensure that their money is allocated towards companies which actively help drive environmental sustainability, might want to look into thematic funds. However, underlying holdings of these funds must be scrutinized, as many companies that do good for the planet are unfortunately far from quality.
https://hqam.ch/en/investing-for-a-green-future/

Do bonds still deserve a place in your portfolio?

Historically, bonds have provided a certain defense against stock market downturns. Since 2004, the volatility of bonds has been ca. three times lower than that of equities. In the US, bond volatility is 5% compared to 16.9% for equities, while in Europe, it's 5.9% versus 17.4% for stocks. There is no compelling reason to believe that this situation should undergo a dramatic transformation, rendering bonds a broken asset class. Bonds show attractive performance prospects and are expected to still offer great diversification benefits to an equity portfolio. However, more expensive borrowing coupled with a weak economy and worse solvency ratios this could lead to higher bond issuer bankruptcy risk.

https://hqam.ch/en/do-bonds-still-deserve-a-place-in-your-portfolio/

Should you invest in companies and funds with high ESG ratings?

Here, we proudly present the results of Incremental Excellence Award as well as discuss its goal. We should reward companies with capital flows that are already performing well in terms of ESG. However, we also strongly believe that the corporate goal of making diligent improvements every year should be at the core of corporate ESG initiatives, and real progress must be demonstrated. We were pleasantly surprised to find that among the improvement leaders were industries typically associated with pollution, disasters, injury rate, and climate warming. Companies in the materials, energy, and utilities sectors demonstrated leadership in terms of improving their ESG standards. Presumably, regulations, pressure from capital holders, and public scrutiny played a role in driving these positive changes.

https://hqam.ch/en/high-vs-improving-esg-rating/

Examples of Portfolio Buy, Sell and Hold Decisions in 2023

See below few of our investment decisions we made with regard to Quality portfolios in the second half of 2023.

Buy Decision

Holcim

In late August 2023, after almost three years of constant monitoring, we added world's largest cement producer, Holcim, to our Swiss portfolio. Because cement is capital intensive business with stiff competition, one might naturally question the timing of such addition against difficult macro environment, especially in the construction space. When making arguments for the Quality style, we often emphasize excellence in corporate governance as one of the prerequisites for business success that sometimes can defy the laws of gravity. And Holcim is a perfect example of how the right CEO managed to turn struggling behemoth operating in the industry that rejects change into a high-margin company that leads green revolution in construction.

Originally, Holcim was of pure Swiss origin, but in 2015 it decided to make a bold move – merge with French Lafarge to form world's largest cement producer. Management at the time set ambitious targets post-merger and promised great things – create best-in-class global portfolio to capture long-term growth opportunities, improve capital discipline and, ultimately, enhance shareholder value. None of which happened, unfortunately, and up until 2019 company failed to deliver promised value accretion, thus underperforming both European peers and general Swiss market. Later on, the stain became even bigger when it came to light that legacy Lafarge has been involved with terrorist organizations in Syria, where it paid ISIS to keep own operations running uninterrupted in the country from 2013 to 2014.

Managerial relief came in October 2017, when former CEO of Sika (another high-quality Swiss chemical company) Jan Jenisch decided to take up the challenge and give LafargeHolcim a "Sika-like" makeover. Mr. Jenisch is well known in the domestic market as a man with a strong character and track-record of under-promising, but overdelivering. Therefore, when he announced new strategy that called for 1) significant divestments of complicated assets - mostly in Emerging Markets - to improve profitability, 2) diversification away from cyclical cement by means of focused bolt-ons in high-margin and more resilient Roofing, 3) simplification of structure to focus on performance and 4) higher cash conversion, market was in no way skeptical. But perhaps the most visionary step Mr. Jenisch took was in the direction of green technologies and sustainability.

Construction industry, and cement production in particular, is extremely emission-intensive business that has long resisted change, especially when it comes to decarbonisation, digitalisation, green products, and circularity. Early on Holcim (in the mid-2023 company dropped Lafarge altogether from its name to distant itself from bad reputation of French business) realised that sustainability will be one of the most disruptive challenges in the history of construction and decided to hop on the train first and lead the way, thus securing itself leadership position in the field. Already in H1'23, 18% of Holcim's concrete sales derived from EcoPact - Low carbon concrete with CO2 reduction of 30% to 100%, while 10% of cement sales were generated by EcoPlanet low carbon cement. As both come at a premium versus regular cement, this has allowed Holcim to maintain sales growth and profitability in the category in 2023 despite mid-single digit drop in volumes, especially in Europe.

Although fruits of new strategy became visible already in 2020, when company became quality, we took our time with Holcim. Yes, the margin volatility was resolved and showed positive dynamics, comparable sales growth was no longer choppy and there were visible improvements in capital profitability. But if there is anything we learned from our decades long investment experience is that a transformation story is a risky bet that can end up going either way – things happen. We had to see if the improvement in fundamentals was indeed sustainable and whether new Holcim would remain robust if environment is no longer accommodating. Once both proved to be true, we added the position straightaway and by the end of 2023, a little bit over four months in the portfolio, Holcim has returned 12.3% and outperformed SPI Index by 11.2%.

Keep Decision

Lonza

More often than not, “when it rains, it pours” as famous proverb goes saying. This is especially true for the stock market and last three years have been a very good example of how things can go from bad to worse very quickly and how merciless the sentiment can be, once it decides upon the direction. In 2023, Lonza, Swiss contract manufacturer, has experienced that force firsthand.

Share price of the company took the first significant hit mid-summer after it was forced to slightly adjust full-year guidance on the back of lower level of corporate biotech funding and ongoing weakness in the capsules business. Later on, market was caught off guard when Lonza announced a surprised departure of its CEO, while the latest wave of sell-off occurred in October when new mid-term targets for 2024-2028 failed to impress investors. Company has been a long-term holding of our Quality Swiss portfolios, since distant 2016, and although in 2023 it lost close to 30% of its value, we nevertheless made over 115% gain over the holding period with 50% outperformance versus SPI Index.

To understand why we remain committed to Lonza, it is important to understand the business itself. Company is the largest Contract Development and Manufacturing Organization (CDMO) globally, with undisputed leadership in biologics when it comes to the manufacturing capacity. In the industry that is fragmented with over 1,000 active companies (top 10 own less than 20%), size and reliability are critical attributes to build long-term relationships with big pharma and smaller biotech.

Poised to overcome challenges thanks to its industry leadership, strong business model, and resilience against economic shocks.

Because once the client is signed, he is locked up until the end of a lifetime of a particular drug as switching costs makes it economically implausible to change the partner along the way. The business, therefore, is very “sticky”. Lonza has always been known for its scale and quality of operations and had never had major reputational stains (like Catalent had with manufacturing of ingredients for NovoNordisk’s weight loss drug Wegovy). Industry itself follows growth in the global pharma market (2020-2025 CAGR of +5%) and thus is vaguely affected by economic cycles, while ongoing outsourcing trend creates long-term, sustainable growth driver.

There are downsides as well and most prominent one is capital intensity. To ensure future growth, CMDOs have to invest a lot, 3 to 4 years in advance, and the bigger is the future project the longer it takes to build the required capacity and the more CAPEX it requires. CAPEX at Lonza has accelerated consistently and in 2023 reached substantial 30% of sales. Commitment to CAPEX, despite difficult macro environment, was a specific beef that market had with the company. Why not freezing some projects to preserve the margin was a fair question everyone kept asking. But getting a customer early is essential for future growth, and Lonza knows that very well, especially given intensified competition from its Asian counterparts, like Wuxi and Samsung biologics. Yes, assets might not be in the commercial stage and risks of pipeline failures are indeed present, but these are the rules of the game. Seventy percent of Lonza’s business is in the commercial and generates consistent cash flow, while new CAPEX projects are always de-risked either by anchor customer or a long-term supply agreement. Importantly, despite significant CAPEX spent, Lonza commands best-in-class EBITDA margin (30% in H1’2023) among both US and Swiss peers, which underscores robustness of the business model.

Although we acknowledge that the reset of margin targets for the next five years to a lower, albeit still very healthy, level is concerning, after a deep dive into the company, we, at the moment, remain convinced that Lonza will continue being a resilient business and outperform broader market, same as before, across major modalities. The very nature of the industry exempts Lonza from major economic shocks, which is especially significant argument in the face of possible recession ahead.

Sell Decision

Kering

We included Kering in our European portfolio in August 2021. The company exhibited business improvements, and the luxury sector had recovered from the challenges faced in 2020 when the industry was heavily impacted by the pandemic. Furthermore, the medium- to long-term growth fundamentals of the luxury market were unaffected; on the contrary, the crisis intensified several trends observed earlier, thereby accelerating the ongoing market transformation.

Kering, with its flagship brand Gucci, was among the first to recognize the power of millennial consumers, experiencing tremendous growth from 2017 to 2019. Gucci contributes to 60% of Kering's revenues and over 70% of the group's profit, making it the primary driver of the company's growth. In 2021, new Gucci collections hit the market, and in conjunction with the release of the House of Gucci film, they were expected to be catalysts to boost the brand in the second half of the year, closing the momentum gap with the industry leader LVMH, which had a particularly strong recovery from the pandemic.

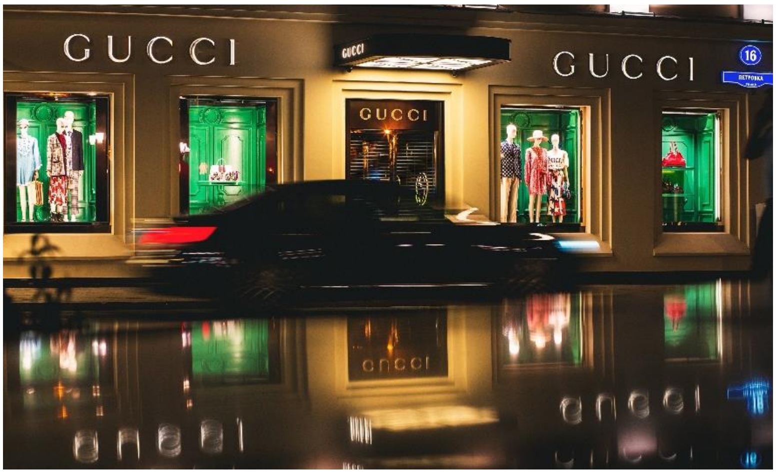
However, despite strong performances from other brands (e.g., Yves Saint Laurent, Balenciaga), the high-margin Gucci did not experience sufficient growth (mainly due to poor performance in China), affecting the overall profitability of the company. Even with solid organic sales growth of 9%, it was insufficient to keep pace with LVMH and Hermes, which recorded growth above 20%.

The overall performance for 1H 2023 broadly aligned with consistently lowered forecasts. Despite the fact that the results met these diminished expectations, sentiment continued to deteriorate quarter by quarter. With the results, Kering announced management changes along with a 30% stake acquisition in Valentino, which complements Kering's brands. This signaled the group's focus on driving growth and potentially closing the gap with industry growth rates in the following quarters. However, the underperformance trend persisted, and 3Q figures were disappointing, with no indication of a change in the near term. There were no significant one-offs, and almost every category declined in the mid-teens.

Due to declining profitability, loss of market share, and no clear catalysts for improvement, we decided to part ways with the company in October 2023, as it seemed that darker times might be ahead. This decision has proven to be a wise one, as since the sale, the company continued to decline and underperformed the market by more than 10% until the end of the year. During the holding period, we experienced a 27% underperformance.

It must be acknowledged that the luxury market, though more resilient than the mid-to-high-end apparel category, remains a volatile business. Recurring revenues are absent; trends, desirability, and fashion change; and, more importantly, the customer's buying power and preferences constantly evolve. While the sector includes companies with portfolios of enduring high-quality brands (LVMH, Richemont, Hermes, Kering), there are periods where the ability to adapt to new market conditions is crucial, and Kering lacked that in the post-COVID period with its late transition to direct-to-consumer and the loss of Gucci brand awareness.

Despite Gucci being among the first to recognize the power of millennial consumers, it lost to competition in the post-COVID period.



In Focus

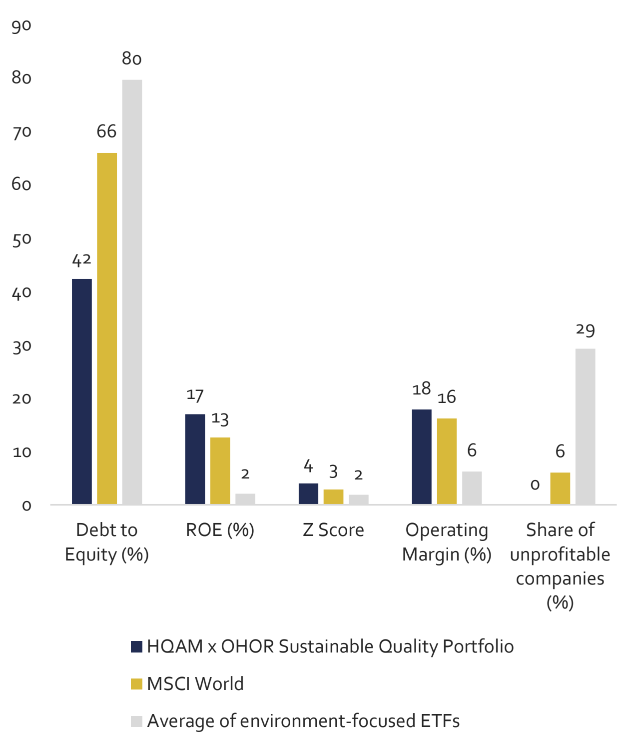
HQAM x OHOR Sustainable Quality Portfolio

All companies included in our Quality portfolios are subject to analysis of ESG factors. However, for investors who wish to take their ESG commitments a step further, we have recently launched HQAM x OHOR Sustainable Quality Portfolio in cooperation with Oliver Heer Ocean Racing (www.oliverheer.ch).

In the spirit of Oliver Heer Ocean Racing Campaign, which has sustainability and climate change at its heart, the Portfolio puts emphasis on sustainable investing and includes an additional environmental theme overlay. While staying true to our established Quality at Attractive Valuation approach, the Portfolio invests in quality companies that help drive environmental sustainability with their products or services.

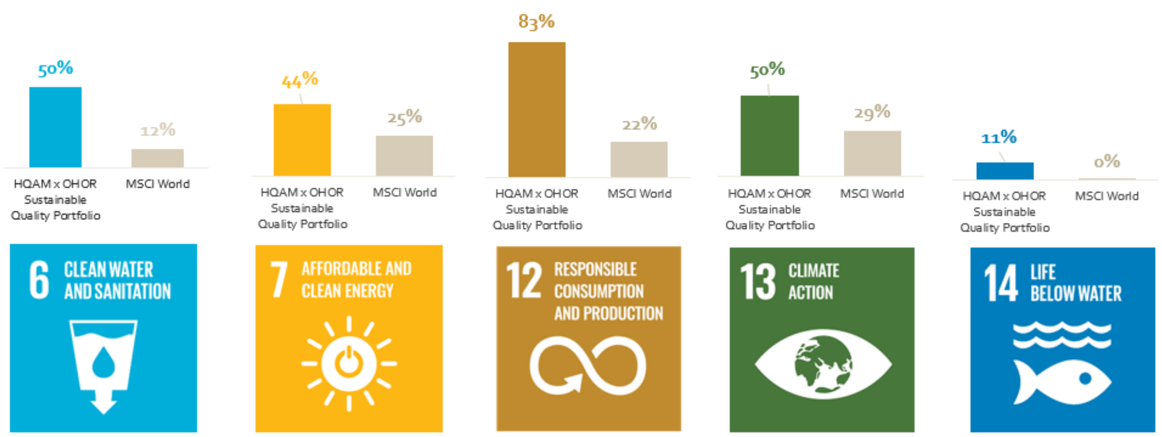
In contrast to majority of thematic funds focusing on environmental issues, which often contain a fair share of emerging unprofitable companies, HQAM x OHOR Sustainable Quality Portfolio only includes companies with an excellent financial quality profile and a proven business model. Highly aligned with sustainable development goals and containing companies that enable resource efficiency, circular economy, greenhouse gas reductions and other environmental objectives, the Portfolio offers investors an opportunity to participate in sustainable transformation while not compromising on quality of their investments.

Fig. 1. Financial quality of HQAM x OHOR Sustainable Quality Portfolio, MSCI World Index and other environment-focused funds (as of 31/12/2023)



Source: Hérens Quality AM, MSCI

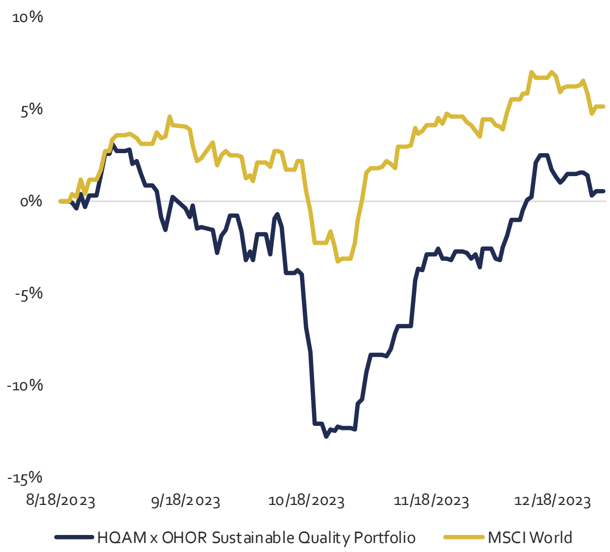
Fig. 2. HQAM x OHOR Sustainable Quality Portfolio and MSCI World Index alignment with Sustainable Development Goals



Source: Hérens Quality AM, MSCI, Refinitiv

Since the launch in mid-August, the Portfolio has had a challenging start. A sharp rise in interest rates and growing recessionary risks affected share prices of some Portfolio companies, which have exposure to economically sensitive industries, such as construction and manufacturing, and to the consumer. However, as financial market volatility subsided, the Portfolio began to close the gap with the benchmark. Further, we observe that in many cases demand for sustainability-related applications remains relatively resilient even in the face of economic weakness.

Fig. 3. Total Return (CHF) of HQAM x OHOR Sustainable Quality Portfolio vs. MSCI World Index since inception (as of 31/12/2023)



Source: Hérens Quality AM, MSCI

One example is a recent addition to the Portfolio - Trane Technologies, a US commercial HVAC supplier, which is experiencing record bookings. Thanks to high energy efficiency and therefore environmental benefits of Trane systems, higher interest rates hardly move a needle in terms of commercial demand, as clients still enjoy significant savings over the lifetime of equipment use.

Of course, sustainability tailwinds should not be overestimated, which was the case with some companies, with whom we had to part ways. This includes, for example, Nibe Industrier, a Swedish heat pump manufacturer, which saw a sharp slowdown in demand amid reduction in subsidies, lower energy prices and sluggish consumer discretionary spending – a perfect storm.

However, for majority of the holdings, the megatrend of sustainability is very tangible and serves as a secular growth driver, positioning the Portfolio well for the long-term.

Incremental Excellence Award

Another recent development on the topic of sustainability was official launch of Incremental Excellence Award (IEA). For a long while, we have been stressing the importance of rewarding companies that consistently improve their ESG performance. While a high ESG rating is commendable, we believe that investors should also support efforts of companies which may still be ESG laggards, but which are working diligently to change this status, as these companies are truly the ones making a positive difference.

The Incremental Excellence Award (IEA) aims to recognize the best companies in terms of improving their ESG status on both quantitative and qualitative dimensions. We compare companies' progress in terms of E, S, and G with their industry peers worldwide, including emerging market companies. The first step involves a quantitative analysis focusing on the dynamics of KPIs that describe corporate commitment to E, S, and G. The second step involves a thorough qualitative analysis, which includes industry-specific KPIs, possible greenwashing detection, ESG goal plausibility assessment, and controversy analysis. The top five companies, after rigorous filters, are presented to the jury for determining the ultimate ESG improvement winner. Eleven well-deserved winners were selected – one for each sector.

While these companies still have ways to ago to achieve the ranks of ESG leaders, the positive impact they have delivered so far by stepping up their ESG game is tremendous, without exaggeration: for example, over the last 3 years, the winners of the Incremental Excellence Award have decreased their cumulative Scope 1 and 2 greenhouse gas emissions by 80 million tons, which equals to annual emissions from about 18 million cars.

We are excited to make the Incremental Excellence Award an annual tradition and are looking forward to see how next year's results would compare to this year's findings.

More information: www.ce-award.com

Fig. 1. Incremental Excellence Award winners

Sector	Winner	Winner Country
Information Technology	acer	
Energy	Shell	
Financials	Amundi ASSET MANAGEMENT	
Health Care	Pfizer	
Industrials	WSP	
Utilities	Iberdrola	
Consumer Staples	Jerónimo Martins	
Consumer Discretionary	YumChina	
Real Estate	ESSEX PROPERTY TRUST, INC.	
Materials	sasol	
Communication Services	cellnex	

Source: Hérens Quality AM

Fig. 2. ESG improvement of Incremental Excellence Award winners

Decreased Scope 1 and 2 GHG emissions by 80 million tonnes

equals to annual emissions from about 18 million cars

Decreased energy use by 194 million gigajoules

enough to power >5 million homes for a year

Decreased number of workplace accidents by 19% (1609)

Increased share of women on board by 7 percentage points on average

Decreased water consumption by 195 million cubic meters

equals to annual water consumption of >4 million people

Source: Hérens Quality AM

Outlook: Rate cuts in focus, quality companies to hold in case of recession

Rate cuts as a risk?

Rates, rates, rates – this word firmly sits in almost every piece of financial news since 2020, after helicopter money was distributed during COVID, and inflation 'showed its teeth.' We are no different to the financial crowd in this sense, frequently mentioning it in our reviews and insights. This time is no exception, as a great deal of attention this year will be devoted to the timing of cutting interest rates, which are at the highest level in more than 22 years. In the end of December, the stock market has already priced in the Fed's three rate cuts, in quarter percentage increments. However, the risk of too early rate cuts might be a concern. So, we hope the mistake of 1980 will not be repeated when the Fed was forced to go for even more hikes instead of continuing rate moderation.

The US economy is holding up well, growing 4.9% in 3Q'23. Also, the forecast does not look too bad, being 1.4% for 2024. Amazingly strong is the labour market, which appears to be the major barrier to start cutting rates. Fig.1. shows that wage inflation is still present. The latest data indicate there was a 5% growth recently, which was quite stable. Besides, the premium for switching jobs has widened once again. So, the battle over wage inflation is not over, and early rate cuts may worsen the situation.

An additional risk factor that could further drive consumer spending is the 'wealth effect,' following the excellent growth of the stock market and booming cryptocurrency markets. Thus, robust consumer spending might not let inflation to decelerate fast enough.

Certainly, both stock and bond investors are eagerly awaiting news about rate cuts. However, historical facts indicate that pause periods might be even more beneficial compared to monetary easing (Fig. 2). So, let's wish Fed to take wise decisions in 2024!

A different story unfolds in Europe, where the economy slid by 0.1% in 3Q'23, influenced by declines in flagship EU economies, Germany (-0.4%), and France (-0.1%). Inflation figures are also more moderate compared to the US: 2.4% vs. 3.1%. Therefore, the rate-cutting policy seems to be implemented first in Europe to revive the economy.

Fig. 1. Wage growth in USA (source: Federal bank of Atlanta, Bloomberg)

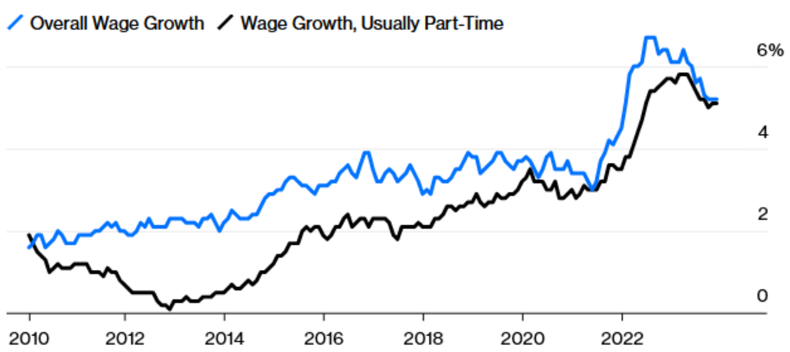
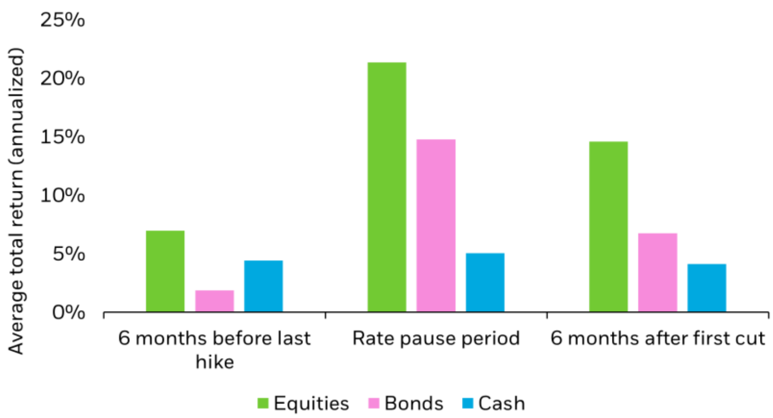


Fig. 2. Asset returns and rate hikes/cuts (source: Blackrock)



Quality companies as a shield

The risks of a recession are mounting as rates are maintained at a relatively high level to tame inflation. The rule of thumb is that the response lag of the real economy is 18-24 months, so economic slowdown is inevitable, and a recession can occur even if rates are cut at the beginning of the year.

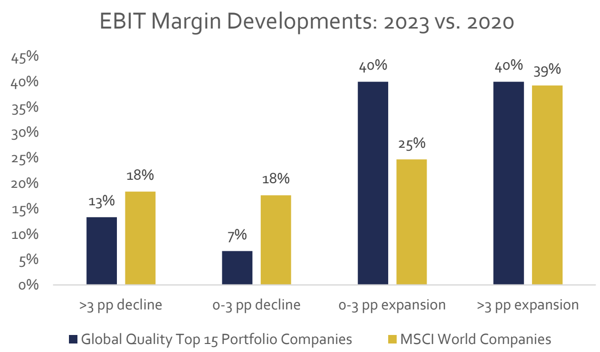
Therefore, corporate resistance is a focal point during our monthly portfolio review process. A great deal of attention is being paid to the margin level of a company and its purchasing power. Fig. 3 shows that the average operating margin of the Quality portfolio is sustainably higher than the market average. Comparing the margin development of Quality companies to how the market performed during the last three years indicates that, in each bucket of margin development, Quality companies outperformed the market. Respectively, 80% of Quality portfolio titles increased their margins compared to 64% of the broad market constituents.

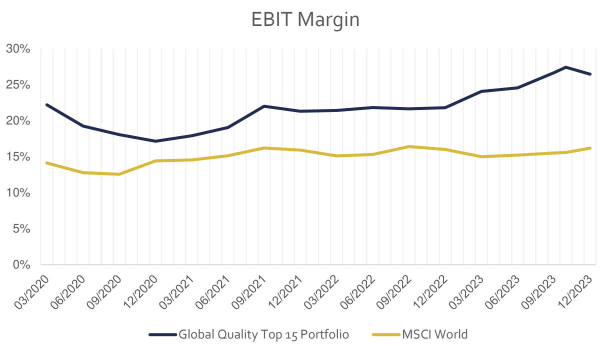
A robust balance sheet is a characteristic trait of Quality companies. As shown in the chart, Quality firms' debt-to-equity ratio falls significantly below the market average figure, with certain deleveraging observed in 2023. The debt level comes into focus when rates are at a high level, ensuring that interest payments do not unduly weigh on the company's profitability and do not excessively expose the company to refinancing risk.

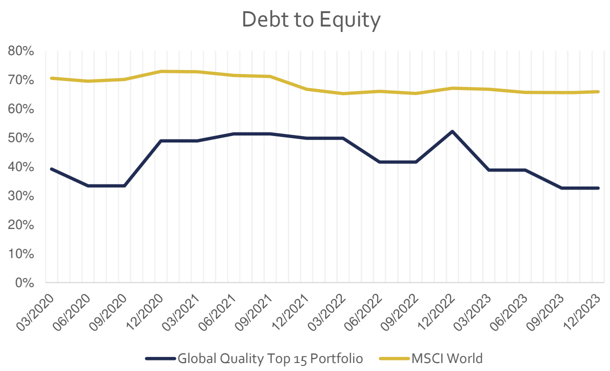
Additionally, the rate of recurring revenue and the quality of cash flow generation are also considered crucial constituents of a firm's quality status, aiding the company in maintaining resilience.

The presence of the above-mentioned characteristics ensures the resilience of the company and differentiates a quality company from its non-quality peers. The status of being a quality company becomes a necessity during economic downturns.

Fig.3. Profitbaility and financial stability of Quality companies vs. MSCI World (source: Refinitiv Eikon, HQAM)







About Us

Hérens Quality Asset Management AG is a highly entrepreneurial and solution-oriented investment management boutique focused on Quality investments since 2003. Our investment style is traditional, timeless and has its own performance and risk character. We believe that a clear, disciplined and systematic analysis offers the key to sustainable investment success. In both bond and equity asset classes, our analysis is based exclusively on proprietary research and analytical tools.

Performance overview

Quality Composites*	2023	2022	2021	2020	3Y p.a.	5Y p.a.	Annual Return	Since Inception	Alpha**	Inception Date
USA (USD)	36.8%	-31.5%	23.2%	28.5%	4.9%	15.0%	11.1%	724.3%	1.3%	1/1/2004
S&P 500 Gross TR (USD)	26.8%	-18.1%	29.6%	18.4%	10.4%	15.9%	9.8%	543.3%	-	
Out-/Underperformance	10.0%	-13.4%	-6.4%	10.1%	-5.5%	-0.9%	1.3%	181.0%	-	
Europe (EUR)	21.3%	-21.9%	30.1%	8.4%	7.2%	12.7%	8.8%	442.6%	2.5%	1/1/2004
Stoxx 600 Net TR (EUR)	15.9%	-10.6%	24.9%	-2.0%	9.0%	10.0%	6.6%	261.3%	-	
Out-/Underperformance	5.4%	-11.3%	5.2%	10.4%	-1.8%	2.7%	2.2%	181.3%	-	
Switzerland (CHF)	8.3%	-23.3%	30.2%	14.8%	2.6%	10.6%	8.6%	423.7%	1.8%	1/1/2004
SPI (CHF)	6.1%	-16.5%	23.4%	3.8%	3.0%	8.2%	6.7%	267.7%	-	
Out-/Underperformance	2.2%	-6.8%	6.8%	11.0%	-0.4%	2.4%	1.9%	156.0%	-	
TOP 8 (CHF)	36.0%	-34.8%	41.9%	16.8%	8.0%	14.2%	14.9%	261.6%	7.2%	10/1/2014
MSCI World Net TR (CHF)	12.7%	-17.0%	25.7%	6.0%	5.5%	9.3%	7.4%	93.8%	-	
Out-/Underperformance	23.3%	-17.8%	16.2%	10.8%	2.5%	4.9%	7.5%	167.8%	-	
Global Quality TOP 15 Equity Fund I Class (EUR)	31.3%	-26.0%	37.5%	12.5%	10.1%	-	11.5%	58.8%	0.7%	10/1/2019
MSCI World Net TR (EUR)	19.6%	-12.8%	31.1%	6.3%	11.0%	-	10.6%	53.3%	-	
Out-/Underperformance	11.7%	-13.2%	6.4%	6.2%	-0.9%	-	0.9%	5.5%	-	
Aramus Japan Equity Fund I Class (JPY)	22.7%	-17.2%	2.9%	32.5%	1.5%	8.8%	7.3%	112.6%	-1.2%	4/1/2013
TOPIX (JPY)	25.1%	-5.1%	10.4%	4.8%	9.5%	7.3%	8.2%	134.2%	-	
Out-/Underperformance	-2.4%	-12.1%	-7.5%	27.7%	-8.0%	1.6%	-1.0%	-21.6%	-	

* Composite: incl. transaction costs, div. reinvested, without management fees
** Annualized Alpha (risk adjusted)

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Source: Hérens Quality AM

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