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Sustainable Companies with Attractive Valuation and Stable Earnings Outlook

Diego D'Argenio, Senior Portfolio Manager of the SAM Sustainable Global Active Strategy, and Kai Fachinger, Senior Portfolio Manager of the SAM Sustainable European Equities Strategy, explain how sustainability has helped their portfolios' performance despite the ongoing financial slowdown, and offer their outlook for 2012.

What distinguishes your Global/European equity portfolios from traditional/mainstream equity managers?

Diego D'Argenio: Our investment philosophy is based on a long-term approach that combines a focus on sustainability with uncovering value. Our sustainability core equity strategies systematically integrate sustainability research into fundamental analysis in order to build portfolios that offer exposure to attractively valued sustainability leaders.

As part of our sustainability analysis, we look at extra-financial information such as brand management, crisis & risk management processes and innovation, all of which are a reflection of sound company management. Our approach is a high conviction stock selection approach that results in a concentrated portfolio of attractively valued companies that focus on quality, innovation and productivity in order to maintain their competitive advantage and ultimately, to create long-term shareholder value.

What is the benefit of including sustainability in your investment decision?

Kai Fachinger: Our sustainability measure allows us to identify companies that exhibit an ability to prosper and grow despite tough economic environments. We have observed that typically during a risky environment, sustainable (i. e. quality) companies tend to perform better and are less volatile than the general market. Quality is more relevant in a turbulent environment.

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Sustainability is a reflection of sound management practices because these companies anticipate sustainability challenges and translate them into opportunities. They also exhibit a high degree of innovation, which allows them to expand their businesses and flourish – even in a tough market environment. Thus, over the long-run, sustainable companies tend to perform better.

How have the portfolios performed in the last year? Over the past three years?

Fachinger: In 2011 our Sustainable European Equities Strategy performance was down 8.4 % in absolute terms, slightly underperforming the MSCI Europe benchmark by approximately 13 basis points (EUR, gross of fees), while our Sustainable Global Active Strategy returned –4.2 %, 161 basis points below the MSCI World benchmark. Since inception, both the Global Active and European Equities Strategy have outperformed their benchmarks. These performance results are particularly noteworthy given that these portfolios are highly concentrated and fully invested, reflecting the effectiveness of our stock selection capabilities.

What is the current positioning in your portfolios?

D'Argenio: Given the fact that we are in the midst of a financial crisis and we see a slowing global economy with a weak environment for consumers, we feel it is better to be invested in companies with global exposure and strong balance sheets.

We avoid unsustainable companies. During challenging financial environments, pressure on margins is greater, and return on capital is squeezed. Unsustainable companies tend to lack the innovation potential that allows them to enjoy a sustained level of profitability when the market is shrinking.

Have you made any changes to your portfolios in response to the debt crisis?

D'Argenio: We feel that it is appropriate to maintain a more defensive position as we have a cautious view on equities, given the uncertainties in Europe.

At the beginning of 2011, our portfolio positioning was already rather defensive, with an overweight in telecommunications, utilities, and healthcare, and an underweight in discretionary goods, IT and financials.

Within the financial sector, our cautious approach has paid off so far. Our performance in this sector was actually relatively good, indicating that our stock selection worked well. Within the financial sector, we avoided banks, but selectively invested in some quality banks in countries that are less affected by the Euro crisis, such as Canada and Norway, for instance.

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Given the current situation in Europe, should investors be invested in European equities?

Fachinger: Many European companies are global players with diversified markets for their products and services, some of them offering a higher exposure to the global economy than their US or Asian competitors.

After the strong market correction in European equity markets, we now see interesting investment opportunities. In particular, we like oil service and some food retail companies as they offer exposure to the global economy with a valuation discount relative to their global peers. Within financials, we prefer insurance companies offering a better risk-return profile, while the banking sector remains weak and entirely dependent on policy response rather than on economics and fundamentals.

What is your outlook for 2012?

D'Argenio: We believe equity markets will continue to be heavily influenced by any further political and fiscal decisions aiming to ease the strain on financial markets. In addition, as Western governments are undertaking austerity measures aiming to contain high debt levels, further meaningful government stimulus programs appear unlikely. The Fed and the ECB will continue their accommodating monetary policy for the foreseeable future. We maintain a cautious outlook for the stock markets as the overall macro picture remains tepid, and the sovereign debt issues are far from resolved.

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The current valuation level of companies in our portfolios, however, is attractive, and our Global and European equity portfolios should benefit from their positioning in companies that offer growth at a reasonable price. While the investment strategy remains focused on investing in sustainable companies with attractive valuations and a stable earnings outlook, we also maintain an underweight in sectors where earnings visibility is lower, namely financials.

Diego D'Argenio, CFA
Senior Portfolio Manager
SAM Sustainable Global
Active Strategy

Diego d'Argenio is a Senior Portfolio Manager and is responsible for the SAM Sustainable Global Active Strategy and is the Deputy Portfolio Manager for the SAM Sustainable European Equities Strategy. Prior to joining SAM in 2005, he was an equity portfolio manager and member of the Investment Committee responsible for tactical asset allocation at ARCA Asset Management in Milan. He began his investment career as a financial analyst at Kuwait Petroleum. Diego d'Argenio holds a degree in Economics from Rome University. He also earned a Master's degree in Finance and Investment Banking from the European School of Economics and is a CFA charterholder.

Kai Fachinger, CFA
Senior Portfolio Manager
SAM Sustainable European
Equities Strategy

Kai Fachinger is a Senior Portfolio Manager and is responsible for managing the SAM Sustainable European Equities Strategy and is the Deputy Portfolio Manager for the SAM Sustainable Global Active Strategy. From 2006 to 2007, he was a Financial Engineer at Allianz Global Investors, where he was responsible for asset liability studies as well as for concept studies for life cycle and decumulation solutions. Kai earned his degree in Mathematical Finance from the University of Constance, Germany in 2006 and is a CFA charterholder.

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