AMG Schweizer Perlen

Full-Year Report 2022

The year 2022 will go down in the history of the markets as an annus horribilis. No sooner had Covid become history than Russia's brutal war of aggression against Ukraine began in the middle of Europe, turning many things upside down that had seemed unthinkable in advance. It led not only to the eradication of the seemingly fragile peace order in post-(world)war Europe and thus to immeasurable suffering and destruction, but also to a massive economic shock of unimagined proportions.

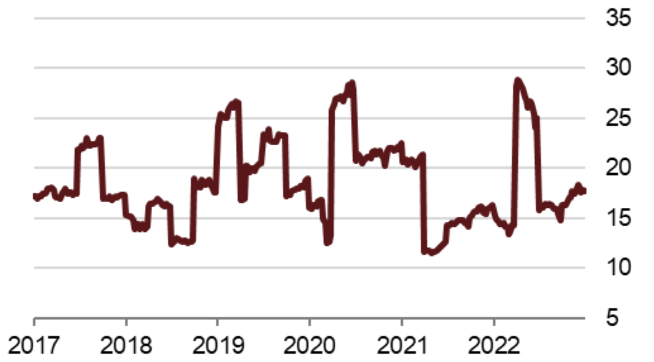
The loss of Russia as a reliable and cheap energy supplier, especially for Europe, hit the world economy unprecedentedly at a critical moment. Namely, when the aftermath of Covid and its effects on supply chains and trade routes were far from over. The fact that the debt levels of many industrialised countries had reached extreme levels in the course of dealing with the Covid crisis and other distortions, and that monetary policy had also reached its maximum effect with negative interest rates, made the global economy even more vulnerable.

The crisis in the energy markets coupled with the difficulties in global supply chains led to a rapid and sharp rise in global inflation. This was on a scale that the world had not seen for a long time and, above all, had not expected. As a result, central banks were forced to shift from a policy of free money to a policy of fighting inflation via a significant increase in interest rates. This led to losses in all asset classes. Not only the stock markets, but also the bond markets and even alternative investments suffered heavy losses; only the commodity markets were on the winning side.

In the real economy, rising interest rates and dwindling consumer confidence in the face of war and inflation led to a significant slowdown in economic development, culminating in the transition to recession. Only the labour market seemed to resist the forces of the market. The extremely rapid and significant economic slowdown with stable labour markets without the emergence of mass unemployment is so far a novelty in economic history.

Stock markets have lost more in this phase than earnings estimates have been reduced. The upward exaggerations in valuations seem to be a thing of the past, with valuation multiples returning to or even falling below historical averages. Either the analysts' estimates are still too high or the multiples have been sustainably reduced and shares have become substantially "cheaper".

Fig.1: Valuation on the Swiss stock market

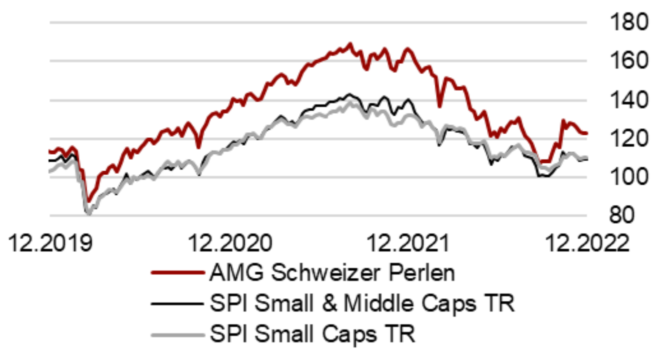


Source: AMG Fonds, Bloomberg, Price earnings ratio (12M forward, SPI Index)

The rise in interest rates causes the present value of future cash flows to fall, which has had a negative impact on the share prices of growth stocks in particular.

The AMG Schweizer Perlen Fund lost 26.1% in 2022 in this market environment (P tranche). The low point was reached at the end of September, since then a moderate recovery has set in. When the market moves upwards, the AMG Schweizer Perlen Fund clearly outperforms the benchmarks.

Fig. 2: Performance comparison over 3 years



Source: AMG Fonds, Bloomberg

The fund has been managed by Ronald Wildmann as portfolio manager since mid-April 2022, together with Patrick Hofer.

Review

In this environment, highly valued growth stocks have lost significant ground. At the top of the list are names such as Bachem, Swissquote, Kardex, Dätwyler and VAT Group, all shares that had lost almost half or more of their value by the end of September. In the fourth quarter, however, they recovered.

We divested from various stocks, such as u-blox (profit taking), ams-OSRAM (disappointing performance), Ypsomed (management problem), Softwareone (disappointing performance), Sulzer ("overhang" Vekselberg) and IVF Hartmann (conflict of interest with parent company). We added Valora to the portfolio and sold it at a profit after its acquisition by a Mexican group. We also added growth stocks such as LEM, Comet, Straumann, Sensirion and Zehnder to the portfolio, as well as other stocks with promising prospects such as Swissquote, Mobilezone and Pierer Mobility. Barry Callebaut, as a defensive growth stock, should contribute to stability in the portfolio. We consider our exposure to Lastminute.com and Peach Property as opportunistic. We benefited from strongly depressed share prices when building up these positions.

A decisive factor for the strong outperformance in the fourth quarter was the sharpening of the orientation of the AMG Schweizer Perlen Fund. We reduced the proportion of value stocks to less than 10% and increased the proportion of growth stocks to well over 80%. We thus focus on shares of companies that are capable of achieving strong cash flow growth. These companies are global market leaders in a niche and are characterised by innovation and cost leadership. They pursue global megatrends such as the "Internet of Things", artificial intelligence, digitalisation, connectivity, energy efficiency, decarbonisation or re- and nearshoring.

Outlook

In this extremely fragile phase, the central banks find themselves between the chair and the bench. Is it now their primary task to fight inflation, or is it to avoid too sharp a recession with its extensive negative social and societal effects? Will the fragile democratic, freedom-oriented order of the West survive the healing effect of a short, moderate recession or do the central banks risk worse with the danger of a long-lasting, sharp recession, such as the collapse of Western democracies and the formation of further autocratic, only "quasi"-liberal democratic political and economic orders?

Thus, due to higher interest rates and inflation, the risks of recession have continued to rise worldwide. However, inflation in the USA seems to have already passed its zenith. The situation is similar in the EU, where the peak may have been reached. Moreover, the situation on the labour markets is not getting any worse. The easing inflationary pressure leads us to expect a more moderate monetary policy. Thus, 2023 could become a year of economic recovery. The stock markets are already anticipating part of the stabilisation. The big question remains where base inflation will settle. Especially in the Western, non-Anglo-Saxon countries, the propensity for wage increases and thus the triggering of a wage-price spiral could be overestimated. Workers in Europe are culturally less flexible than workers in the US or UK and change jobs less often, leading to much more moderate wage increases.

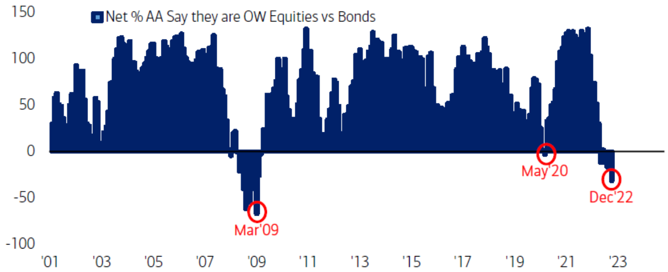
The war in Ukraine and the opening of Covid in China are further components that will give direction to the markets in 2023. An end to the war - not an unrealistic option and one we all hope for - could trigger a rally. For this reason alone, it is worth staying invested. China's departure from its recent disastrous covid policy poses great risks but also great opportunities for the markets. Moreover, the small-cap segment continues to be oversold compared to the large-cap stocks and the turning point seems to have been reached.

Fig. 3: Oversold small-cap stocks signal potential

Source: AMG Fonds, SPI Small Caps vs. SPI Large Caps

Indicators of market sentiment, such as the extent of hedging strategies expressed by the put/call ratio on the US equity markets or the liquidity posture of fund managers according to the Bank of America (BofA) survey, however, continue to testify to an extremely negative attitude.

Fig. 4: Bank of America Survey



Source: BofA Global Fund Manager Survey (December 2022)

The more negative the markets are, the more clearly the recovery that has already begun could continue. With the AMG Schweizer Perlen Fund, we are positioned in such a way that we should benefit excessively from a countermovement of the markets. We are continuing our strategy of focusing on growth stocks.

We would like to thank our valued investors for the trust they are placing in us and wish you a successful investment year 2023.

Your AMG Fonds Team

Portfolio Management

Ronald Wildmann
wildmann@amgfonds.ch
+41 (0)41 726 71 62

Patrick Hofer
hofer@amgfonds.ch
+41 (0)41 726 71 76

AMG Fondsverwaltung AG
Bahnhofstrasse 29
CH-6300 Zug
+41 (0)41 726 71 71
www.amgfonds.ch

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