XANTOS

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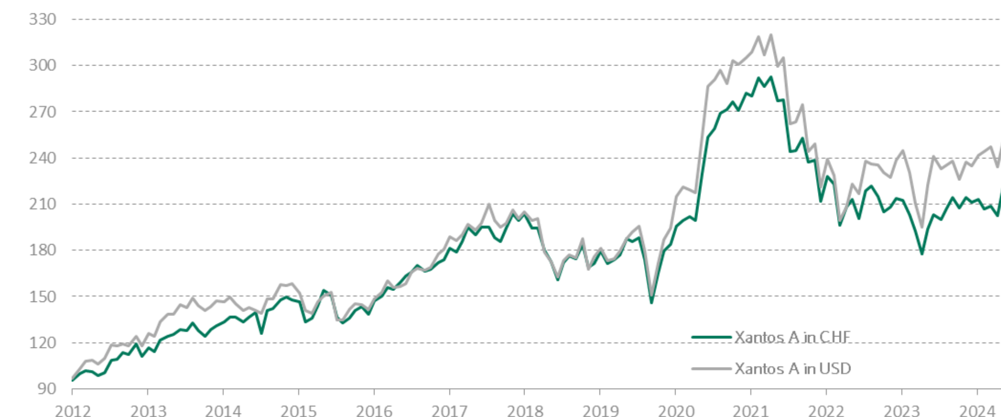
# ANNUAL REPORT 2024

- Positive returns from small and mid caps despite numerous obstacles
- Interest rate cuts and the re-election of Donald Trump have created a favourable environment, but global conflicts and economic uncertainties are holding things back
- Strong regional differences in performance – with the US outperforming Europe to the most significant extent since 1976
- Investments in artificial intelligence continue, fuelling large cap tech stocks
- Xantos share class A achieves a return of +6.9% (CHF) and -0.7% (USD) driven mainly by US stocks in the information technology, financial and industrial sectors
- The outlook for small and mid caps remains bright, bolstered in the US by tax incentives, deregulation and protectionism
- Lower interest rates have created good conditions for small and mid caps, supported by attractive valuations
- Economic and interest rate outlooks remain decisive

## Performance of Xantos A




Past performance is not indicative of future results.

## Lacklustre start to the year for small and mid caps

Small and mid caps got off to a very subdued start in the new year. Inflation and interest rates continue to be the dominant themes in discussions and events on the markets. The US economy also demonstrated strong growth in the first half of the year, while China and Europe faced weak economic growth or a recession. The slowdown has been particularly evident in the real estate market, industrials and small and mid caps. Despite the tougher environment, many companies have been managing to remain profitable. The majority of companies will remain reticent for the next few months. Due to the uncertain

prospects of sales and profit, stocks in many companies are under pressure. The effects of the sharp increase in interest rates are becoming ever more apparent.

### Inflationary pressure easing in Europe, with growth problems taking centre stage

US growth remains surprisingly high. However, more and more clouds are forming in the economic sky and economic indicators appear to be cooling. China is stuck in a deflationary spiral, while Germany – the beating heart of the European economy – is falling deeper and deeper into recession. Inflation is continuing to ease, albeit not as quickly as hoped. There is increasing scope for central banks to intervene in response to any economic weaknesses. In a surprise move in March, the SNB announced a turnaround in interest rates by bringing in its first rate cut. Europe also took initial measures with regards to interest in June while the US appears poised to follow suit.

### Strong annual financial statements and better-than-expected outlooks help Xantos achieve positive returns in the first few months

Following the previous year's year-end rally, profit-taking was reported in the first few weeks of 2024. In February and March, Xantos profited from rising share prices, driven by strong annual financial statements and better-than-expected outlooks (Coherent, Fortnox, Pegasystem) for this year. The positive return in the first quarter is mostly attributable to investments in the defence industry and the information technology sector. Last year's affairs continued to dominate the performance of certain sectors. In the case of the technology sector, this was artificial intelligence (AI); in the healthcare sector, it was GLP-1 weight loss injections, while in the industrial sector, it was the defence industry.

### Stubbornly high inflation and strong employment figures in the US cast doubt on interest rates falling any time soon, weighing on markets at the start of the second quarter

As the saying goes, "good news becomes bad news", and sure enough, strong US economic data and higher commodity prices at the start of the second quarter fuelled doubts about the speed of monetary policy easing. If, at the start of the year, the market was still predicting six base rate cuts of 0.25 percentage points each, expectations have since been revised down to just one or two rate cuts. Stock markets have been reacting negatively to the continued interest rate increases. Even Xantos has been unable to resist the selling pressure. On top of this, geopolitical risks (Ukraine, Middle East, Taiwan) have been consistently weighing down the markets. After the European elections, European markets in particular, were further depressed by political power shifts and uncertainty.

### Better-than-expected corporate profit figures and uninterrupted AI hype buoy equity markets – Xantos reaches a new annual high

A strong US reporting season and the relentless hype surrounding artificial intelligence (AI) catapulted the major US indices to new all-time highs in the second quarter, with May more than making up for the falls in April. Xantos, too, climbed to a new annual high. Inflation data in the US proved better than expected, fuelling hopes for interest rate cuts in the near future and triggering a veritable rally in small caps in July, resulting in yet another annual high for Xantos. There was great hope that profits would recover over the course of the year, especially as the overall market's profit increase was attributable to a small number of mega caps.

### Fears of recession weigh down markets at the beginning of August, but hopes of rapid interest rate cuts bring fresh market momentum

Weaker-than-expected US labour market data clouded the mood in early August, with equity markets more or less collapsing in light of the increased risk of recession. The unexpected interest rate hike by the Bank of Japan also triggered a substantial reversal of the yen-USD carry trades (activities relating to the difference in interest levels between the yen and USD), causing the Japanese equity market to slump by 20%. Fears of a slowdown in growth bolstered hopes for imminent interest rate cuts in September. The global equity markets began to recover rapidly, making up for the losses at the start of the month.

### Fed initiates rate cut cycle

After more than four years, the US Federal Reserve reduced the US key interest rate by 50 basis points in September, kicking off its cycle of rate cuts with a bang. This raises the question of whether the US economy is in worse shape than the markets think. China has seen a heightening risk of deflation, with increasing calls for further action to break the vicious circle of declining corporate sales, wages and expenses. A larger set of measures to boost growth was also announced at the end of September.

### Economic and interest rate outlooks remain decisive

With US labour market data proving significantly better than expected (in September, most jobs had been in place for six months), the market received a fresh boost at the beginning of October. At the same time, however, expectations regarding interest rate cuts declined. While economic growth in Europe and China continued to disappoint, the US did not seem to be showing any signs of a slowdown at this point. The unexpectedly sharp rise in interest rates dampened stock market euphoria and caused some drops in share prices. Rising interest rates had a particularly negative impact on bond proxies such as real estate stocks. The sales and profit figures for the third quarter were quite different. Information technology and data centres related shares continued to yield the most momentum for growth.

**Donald Trump's victory sets prices sky-rocketing in November – Fed dampens interest rate cut expectations in December**

Republican candidate Donald Trump emerged the surprise winner in the US presidential election, claiming the post for the second time since his previous triumph in 2016 and triggering a veritable explosion in prices on the US equity markets. The markets anticipated potentially positive earnings effects through tax cuts and deregulation. The reaction on the European and Asian markets was more modest due to the prospect of tariffs. At the same time, long-term US interest rates continued to rise at first and the US dollar appreciated sharply due to the anticipated inflationary impact of Trump's policy measures. The initial euphoria in the US was followed by disillusionment with the appointment of various controversial ministerial candidates, putting considerable pressure on stocks such as those of consulting firms that generate a significant proportion of their income through dealings with the US government. Fears of spending cuts also affected the defence sector.
The Fed's restraint at its final meeting of last year once again caused some alarm amongst investors. The decline in inflation continued to be sluggish and further interest rate cuts may also take a long time to come.

# Portfolio

## Performance drivers

**Performance mainly driven by US equities**

Last year turned out to be one of the worst of all time for European equities compared to US equities. It is therefore no surprise that 95% of Xantos' total return was generated by US equities, with an average US investment weight of only around 43%. The US economy proved much more robust than expected at the beginning of the year, while the expected recovery, particularly in Europe's industrial sector, continued to lag. European equities therefore only accounted for a disappointing 5% of the positive total return.

**Positive sectors: Information technology leads the way, followed by financials, industry and energy**

In sector terms, around 75% of Xantos' performance in 2024 can be attributed to the information technology sector, which continues to hold the largest weighting in the fund (average weighting last year: 37.8%). The financial, industrial and energy sectors in particular also made positive contributions to returns.
Within the information technology sector, Coherent (optical communication, US) was the top performer, followed by SiTime (semiconductors, US), Pegasystems (software, US), Lumentum (optical communication, US), Semtech (semiconductors, US) and CyberArk Software (internet security software company).

In terms of financial stocks, Mapfre (Spanish property and casualty insurance provider), Nordnet (Swedish digital bank) and Axos Financial (US digital bank) played a particular part in the positive performance of returns last year.
Within the industrial sector, the largest positive contribution to returns once again came from defence companies (Rheinmetall, Saab AB, AeroVironment), which are continuing to profit from geopolitical uncertainty and global rearmament.
In the energy sector, Kinetics (Midstream energy company, US), Archrock (natural gas compression services, US) and Oceaneering (offshore oil services and equipment, US) were the strongest contributors to the positive performance.

**Negative sectors: Healthcare sector disappointing, with materials, consumer staples and real estate also dampening performance**
The healthcare sector performed underwhelmingly last year. Companies such as Alphatec (US medical technology) and Quanterix (US diagnostics) in particular, came under pressure to sell. The materials and consumer staples sectors (Ocado, UK) also made negative contributions to performance. The development of our ventures in the Swedish (Catena, NP3 Fastigheter, Nyfosa) and British (Persimmon, Berkeley) real estate sectors did not meet our expectations. However, Cairn Homes, our real estate investment in Ireland, performed very well.

At the level of individual securities, the largest positive contributions to returns came from Coherent, SiTime, Pegasystems, Lumentum, Semtech, CyberArk Software, Rheinmetall, Saab AB, Veracyte (US diagnostics) and Cairn Homes. Alphatec, Quanterix, Sinch (Swedish communication platform-as-a-service company), Kalray (semiconductors, France), Alfen (smart power solutions, Netherlands) and Ocado (robotics platform for UK online grocery) had the greatest negative impact on returns.

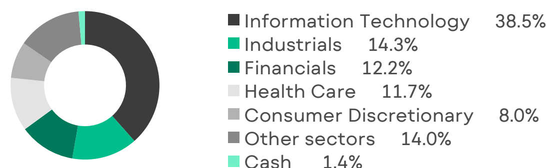
## Portfolio structure and adjustments

Xantos kicked off this year with a cash ratio of almost 10%. In sector terms, Xantos had invested almost 40% in information technology, 16% in the healthcare sector and 11% in industrials as of the start of the year. In geographical terms, 49% of assets were invested in Europe and 39% in the US.
In view of falling interest rates, we established a small position in the UK homebuilding segment back in January and also opened a position in the Swedish real estate market towards the end of the second quarter. Over the course of the year, we cut back somewhat on certain positions or sold them off completely, especially in the area of information technology, due to their positive performance and increasingly ambitious valuations. We also reduced the weighting in the healthcare sector by around 5%. This sector proved

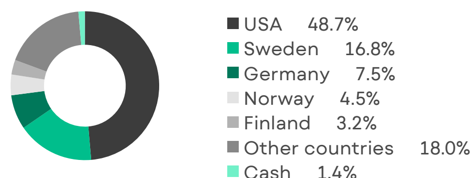
disappointing last year and we do not see any prospect of a sustained recovery at the moment (headwind from China, US drug prices, patent expiry). We also realized some gains in the defence sector, but we are still invested at around 5% in this industry. Amongst other things, we have made some investments in the industrial sector, particularly in Europe, where we expect a gradual recovery in profits following the industrial recession.
The cash ratio at the end of the year was 1.4%. Around 49% of assets are invested in the US and 48% in Europe. In sector terms, Xantos had invested just under 39% in information technology at the end of 2024, along with 14% in industrial companies, 12% in financial stocks and almost 12% in the healthcare sector.

### Xantos sector and country breakdown at the end of December 2024

Sectors in %




Countries in %




# Outlook

### How long will the US equity market continue to be driven by mega caps?

Once again, large caps outperformed small and mid caps last year, with mega caps in particular performing significantly better. Performance in the US equity market is increasingly underpinned by a handful of mega caps. Comparing the performance of the S&P 500 Index (market cap-weighted) with the S&P 500 Equal Weight Index (equal-weighted) shows just how extreme the outperformance of the mega caps is. Similar levels of mega cap outperformance have not been seen since the great financial crisis of 2008/2009, peaking in November 2008. The market performance became more broadly based again after that and a strong small and mid cap rally began.

### Relative performance of the S&P 500 Index (market cap-weighted) versus the S&P 500 Equal Weight Index (equal-weighted)

### Trump’s policies will help domestically oriented companies

Recent equity years have been shaped by major US tech stocks (the "Magnificent Seven"). However, there are various signs indicating that this era is coming to an end. Republican policies in the US are likely to support domestically oriented companies, while tax cuts and deregulation will have a positive impact on profits. With this in mind, small companies – at least on the other side of the Atlantic – are once again taking a more optimistic view of the future. At the same time, supply chains and supply issues should also help continental companies in Europe. There are signs of a gradual normalisation of the interest rate structure, which is likely to benefit interest rate-sensitive companies, in particular. Ultimately, AI technologies are slowly making their way into smaller players. These developments have also been reflected in the stock market prices of medium-sized companies for several months now, and increasingly in those of smaller companies too.

### Geopolitical tensions and a flood of regulations are hampering growth at local level – worldwide rearmament continues

Even after two years, the war in Ukraine is still raging. On top of this, there are the war in the Middle East, tensions between China and Taiwan and the trade conflict between China and the United States. The list of global crises is long. There is a great deal of uncertainty in the world, which is why states will continue to invest heavily in defence. While various states are ramping up their defence investments, the tense global situation is continuing to put pressure on companies’ investment plans. Geopolitical issues and wars are currently leading to increased market volatility. The flurry of regulatory activity in Europe and China is not benefiting the economy either. There are certainly some positive developments to be expected from the US in terms of regulation under the new administration.

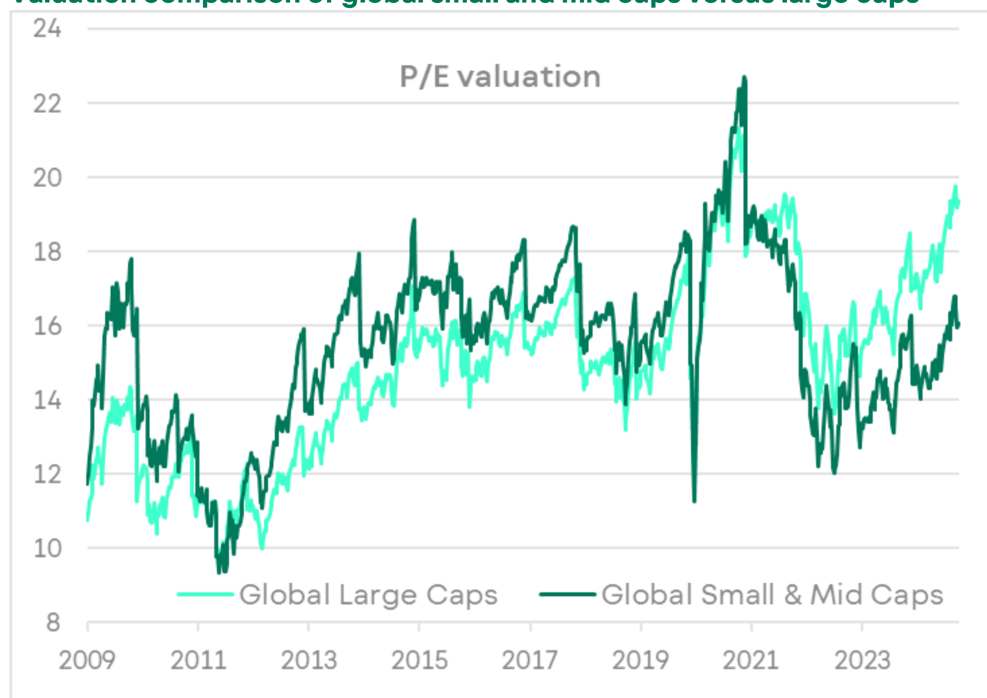
## AI remains a hot topic – not least in Europe

In Europe alone, AI spending reached USD 50 billion last year and is set to rise by around 35% in 2025. The biggest challenge in 2024 was meeting high growth expectations at business level. While investments in AI increased dramatically returns for many companies remained limited. The market for AI platforms is currently being driven by companies such as Microsoft, Palantir, OpenAI, Google and AWS, but it remains highly fragmented. Infrastructure providers are entering into strategic partnerships to get into the game. Technologically speaking, however, the future will not just be all about AI. Quantum computing, space technology, 6G and various other areas will play a part in shaping technological development. The broad application of these technologies will result in lots of exciting companies emerging across different areas. Perhaps some of these companies will even manage to step out of the shadow of the big US firms.

## Lower interest rates are creating good conditions for small and mid caps

The cycle of rate cuts has begun in both Europe and the US. Lower interest rates will breathe life into the economy. The real estate market will benefit from this (combination of lower interest rates, real estate prices bottoming out, underinvestment and undervaluation), and it will also stimulate consumption and investment. Small and medium-sized enterprises stand to benefit more than most from interest rate cuts, as they have more debt on average than large companies. Lower interest expenses will relieve the burden on many smaller companies and free up liquidity for other areas.

## Valuation comparison of global small and mid caps versus large caps

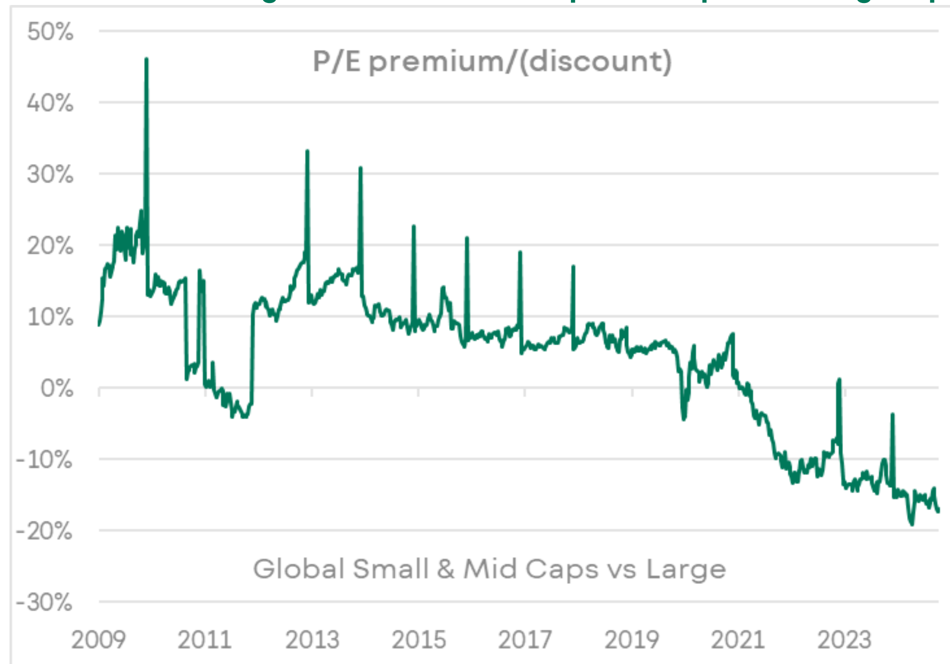


### Global small and mid caps valued more than 17% lower than large caps

The valuation of large caps and in particular mega caps has become more demanding and leaves no room for nasty surprises in terms of sales and profit trends. Small and mid caps, on the other hand, are attractively valued, even by historical standards. Globally, small and medium-sized enterprises are currently trading with a valuation discount of more than 17% compared to large companies, whereas in the past they have traded at a premium.

The following valuation chart clearly shows the trend. In boom phases, small and mid caps trade with a 20% premium over large caps. In the last 10 years, the premium has consistently declined and, since 2021, small and mid caps have even been trading at a discount as compared to large caps. This year, the valuation discount of small and mid caps has increased yet again. The reversal from valuation premium to valuation discount clearly demonstrates the impressive potential of small and mid caps.

### Lower valuation of global small and mid caps as compared to large caps




### The outlook for small and mid caps remains positive

In the US, the Trump administration will implement a domestically oriented economic policy by means of tax incentives, deregulation and protectionism. Small and medium-sized enterprises and domestically oriented companies particularly stand to benefit from this. Should the Fed cut interest rates a little further, this would give SMEs extra impetus. In Europe, interest rate cuts are likely to give a welcome boost to the struggling economy. Europe's innovative strength should not be underestimated. Most significantly, however, there are many attractively valued small and mid caps in Europe that rank amongst the

global market leaders. In recent years, the equity markets have been dominated by a handful of predominantly US companies. There are many factors in favour of broader-based support for growth. In spite of – or indeed because of – the forthcoming US policy, this is likely to mean further geographic expansion.

### A Cinderella story for European small and mid caps

Falling interest rates and technological change will give small and medium-sized enterprises a boost. In the US, the impending deregulation measures are likely to provide further growth impetus. The consensus is that the US stock markets will probably continue to dominate. This is likely to apply predominantly to large companies. The adaptability and innovative capacity of European companies is often underestimated. Many exceptionally well-managed medium-sized enterprises will establish themselves in various technological niches. Combined with the low valuations, there is a lot of potential in store for European small and mid-cap companies.