



Quality, innovation & sustainability

**60 seconds with the
fund manager**



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**This marketing communication is intended for
non-professional investors.**



Geoffroy Goenen

Head of Fundamental European Equity

Geoffroy Goenen and Christian Solé at Candriam explain why it is useful to invest part of an equity portfolio into European small & midcaps.



Christian Solé

Head of Small & Mid Caps

Why should investors take an interest in small & midcaps?

University research⁽¹⁾ has demonstrated that for investors willing to accept certain short-term risks, quality small & midcaps deliver superior long-term returns than large caps.

Small & midcap companies often harbour strong growth potential and the capacity to increase their market share as they are at an earlier phase in their development than larger companies. Niche sector players often enjoy pricing power as well.

We believe that these factors support sustainable regular growth among European small & midcap companies.

What are the advantages of European small & midcaps?

Smaller European businesses enjoy greater exposure to the principal key trends driving success and performance, i.e. innovation, technological disruption

In addition, Europe is the continent on the cutting-edge of sustainability. We therefore have fantastic opportunities to invest in major sustainable themes such as combating climate change and improving healthcare & wellbeing, etc. The whole of Europe plays a major leading role in the theme referred to as the “green industrial revolution”. Many solutions in this field are found among European small & midcaps. Certain companies are sufficiently strong in their domain to become global leaders, despite their initial size.

How does your approach differ to other small & midcap strategies?

As they harbour strong growth, smaller businesses need time to achieve their full potential. We have therefore adopted a long-term approach. Although we invest in companies for an average of three years, we may hold certain stocks in our portfolio for a much longer period.

Above all, profitability is one of our key criteria, whereas many strategies solely seek growth. We invest only in dynamic companies which are already profitable and not just potentially profitable. Although loss-making companies’ share prices can sometimes surge spectacularly in the short term, their survival rate is low which is problematic. Our more prudent approach reduces portfolio risks.

60 SECONDS WITH THE FUND MANAGER

(1) Research example: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2553889

What is your small & midcaps strategy?

Smaller caps are generally covered by a limited number of analysts and some are not covered at all. They may therefore be incorrectly valued by the market, or even undervalued. In our view, ESG⁽²⁾ is an answer to better analyze them.

Our strategy is one of the few in the market which presents sustainability targets with impact indicators, such as the carbon footprint, integrated into our investment approach.

Our active shareholder approach prioritises ongoing long-term dialogue⁽³⁾ rather than an exclusion strategy. Our aim is to support the companies we hold in the portfolio towards improving their governance, greater environmental protection and also developing the key treasure within every company, namely its human capital.

Our experience of larger companies enables us to share the best practices observed in these fields.

To implement our strategy, our ESG research teams composed of 18 members, along with our investment team of 12, work together to pick entrepreneurial companies with a long-term future. The members of our specialist small & midcaps team have an average of 15 years' experience in the financial markets.

How do you pick the companies you invest in?

We look for companies with a market cap of between 250 million and 10 billion euros.

We exclude companies which do not respect the 10 UN Global Compact Principles from our investment universe, along with groups involved in controversial industries such as munitions, tobacco, thermal coal and other businesses that we consider unsustainable. We apply non-financial analysis to understand ESG⁽⁴⁾ risks and opportunities more fully. We also assess companies' exposure to the major sustainable themes



and their relations with stakeholders. This process enables us to reduce the eligible investment universe⁽⁵⁾ by at least 20%.

We then carry out an in-depth analysis of each company within the eligible investment universe based on five fundamental criteria combining financial and non-financial analysis. The five criteria are management quality, growth potential, competitive positioning, high profitability and low debt.

Finally, we value the companies with satisfactory cash positions which appear to have the most promising profile in terms of the five fundamental criteria.

How do you manage the inherent risks incurred by small caps?

Small caps are considered more volatile as they are hit harder than large caps during highly turbulent market periods, chiefly on account of their liquidity. Our investment decisions are therefore not based solely on corporate fundamentals, but also on a liquidity analysis of the stocks. We need to be certain to be able to set up or liquidate a position in under one week during market stress conditions.

Our conservative approach, underpinned by our focus on profitable companies, aims to capitalise on upside potential while also limiting downside risk during market crises. Companies are valued using our proprietary model under specific prudent assumptions in order to avoid overpriced stocks.

(2) Environmental, Social & Governance

(3) For more details on our dialogue and voting policy, please refer to our reference documents on our website.

(4) The ESG analysis for companies described above is applied to at least 90 % of investments in this strategy, excluding deposits, cash positions and index derivatives.

(5) We only take into consideration sectors which are not excluded by the Candriam Exclusion Policy. This document can be consulted on

<https://www.candriam.fr/fr/professional/market-insights/sri-publications/>

Why invest in this strategy today?

The integration of ESG factors into company financial analysis, combined with entering constructive dialogue with managers to encourage best practices, and exercising our voting rights should be a normal process for all engaged investors for whom ESG represents more than just three letters. These three actions have been an everyday reality at Candriam as an investor for more than 25 years.

This strategy therefore provides an investment opportunity on several fronts. We believe that companies which are able to provide innovation and answers to sustainable challenges will see their business expand and will become long-term winners.

The main risks of the strategy are:

• Risk of capital loss:

There is no guarantee for investors relating to the capital invested in the strategy in question, and investors may not receive back the full amount invested.

• Equity risk:

Some strategies may be exposed to equity market risk through direct investment (through transferable securities and/or derivative products). These investments, which generate long or short exposure, may entail a risk of substantial losses. A variation in the equity market in the reverse direction to the positions can lead to the risk of losses and may cause the performance to fall.

• ESG Investment Risk:

The non-financial objectives presented in this document are based upon the realization of assumptions made by Candriam. These assumptions

are made according to Candriam's ESG rating models, the implementation of which necessitates access to various quantitative as well as qualitative data, depending on the sector and the exact activities of a given company. The availability, the quality and the reliability of these data can vary, and therefore can affect Candriam's ESG ratings.

• Foreign exchange risk:

Foreign exchange risk derives from the strategy's direct investments and its investments in forward financial instruments, resulting in exposure to a currency other than its valuation currency. Changes in the exchange rate of this currency in relation to that of the strategy may negatively affect the value of assets in the portfolio.

The risks listed are not exhaustive, and further details on risks are available in regulatory documents.



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Information on sustainability-related aspects: the information on sustainability-related aspects contained in this communication are available on Candriam webpage <https://www.candriam.com/en/professional/sfdr/>.