SMALL AND MEDIUM-SIZE GERMAN COMPANIES: INNOVATIVE AUTOMOTIVE SUPPLIERS PROFIT FROM DIESEL SCANDAL

Andreas Strobl is confident that the MDax will beat the Dax again this year. The manager of the German second-tier stock fund "Berenberg-1590-Aktien Mittelstand" still sees room for growth in German small- and mid-cap stocks despite their good development in recent years. It's primarily the numerous hidden champions helping to drive the digital transformation in many industries that have the best chances for structural growth. However, there are also signs of increased volatility in the coming months.

Secret agreements and the diesel scandal: the heat is on for the large German automobile manufacturers. Their share prices have shown signs of it, as well. Andreas Strobl isn't losing any sleep over it. The second- and third-tier automotive supplier shares which the fund manager holds in his Berenberg-1590-Aktien Mittelstand portfolio are not directly affected by the crisis in the German automobile industry and have not shared in the punishment doled out by investors. "On the contrary, some suppliers have even seen their stock prices go up," says the fund manager, adding, "You have to make a clear distinction about how the individual companies are positioned and affected by structural changes in the automotive industry." He is banking on companies that profit from new drive technologies such as electric motors. "Because of structural change the German automotive industry will have to invest more in research and development in the future. That can happen only as part of a constructive cooperative relationship with the suppliers," Strobl explains. That's why he sees significant growth potential for small companies with a high level of innovation and flexibility. Finding those hidden champions is the key.

Worldwide market leaders with high innovation and structural profits

Such hidden gems are not limited to the automotive industry. Among small and medium-size German companies there are many with a clear competitive position protected by high market-entry barriers or patents. Most are niche players with a focused business model, above-average earning potential and a high level of innovation. Some companies are among the world market leaders in their industry, which allows them to make structural profits regardless of the current business cycle. "Small and medium-size companies have shown in recent years that they can achieve significantly higher returns on equity and total capital than classic large corporations. Higher profit growth and higher yields are compelling arguments for investing in small and medium-size German companies," according to Strobl.

Rising stock prices supported by profit growth at many companies

German small and mid caps have already upped the performance of investor portfolios in recent years. Still, Strobl doesn't think they're too expensive. "The current valuation of Germany's second-tier stocks is slightly above the historical average, but it's still attractive compared to top-tier large caps." It's important to include the persistent low-interest environment when looking at valuation. The stock price increase is also supported by very favourable profit growth at many companies, which Strobl thinks will continue in the coming quarters. However, there's no denying that market expectations are already very high for some companies. Only a few companies delivered pleasant surprises triggering marked share price increases in the most recent reporting season.

For these reasons Strobl predicts greater volatility in the coming months, which he plans to use for making new investments and increasing existing ones. Given this background, the fund's cash ratio is currently above the historical average.

Upswing in Europe’s economy boosting German small and mid caps

Macroeconomic factors might also cause unrest. The further development of the euro-to-dollar rate is particularly critical, according to Strobl. While the internal European market is the most important sales market for most small and medium-size German companies (often making them less susceptible to currency fluctuations than many blue-chips), Strobl warns that “If the euro keeps rising it could have a significant influence on sales and margin growth.” On the other hand, the persistent good economic environment in Europe is having a positive effect on many companies. “Current economic data and also the stabilization of Europe’s political environment make us optimistic that the economic recovery will continue in 2018,” Strobl says. Even a possible course change by the European Central Bank (ECB) is unlikely to make much of a change here. “German small and mid caps have profited from low interest in recent years. Still, most firms have solid balance sheets and strong cash flow, so a gradual rise in interest rates shouldn’t be too much of a burden for them,” says Strobl. Yet ECB decisions are likely to move capital markets in general. But the bottom line is that Strobl remains positive about the European stock market based on the continuing friendly economic environment and good profit growth at most companies.

Improved risk profile after change of managers

Andreas Strobl took over the fund, which was launched in 2015, with Henning Gebhardt at the turn of the year. The fund’s concept was continued consistently. “Based on the favourable performance and constant addition of resources we realized profits and reinvested at the same time. In this way we were able to further improve the fund’s risk profile,” says Strobl. IT and industry shares are weighted most heavily in the portfolio. “That’s where we still see the greatest growth opportunities,” the fund manager says. But he doesn’t look so much to individual sectors; his gaze is rather on the dominant theme of the coming years for German small and mid caps: the digital transformation. Encompassing numerous companies and sub-themes, it affects multiple sectors. Take digital media and digital networking, for example. “We expect structural growth to continue in these areas,” Strobl says.

The fund manager is optimistic that the small players will be the big winners again this year, as in previous years, and that the MDax small and mid-cap index will beat the Dax top-tier index. “Our assumption is validated by growth in both profits and share prices for companies in both indices since the start of the year.”

Overview of the fund and its share classes:

Fund:	**Berenberg-1590-Aktien Mittelstand**	
ISIN:	**DE000A14XN59**	**DE000A14XN42**
Securities ID:	**A14XN5**	**A14XN4**
Investment management company:	**Universal-Investment-Gesellschaft mbH**	
Depository:	**State Street Bank International GmbH**	
Tranche:	**Retail**	**Institutional**
Issue date:	**4 December 2015**	**4 December 2015**
Fund managers:	**Andreas Strobl, Henning Gebhardt**	
Fund currency:	**EUR**	
Total fund volume:	**99.76 million euros**	
Minimum investment:	**–**	**EUR 750,000**
Management compensation:	**1.50% p.a. (eff.)**	**0.75% p.a. (eff.)**
Total expense ratio:	**1.90%**	**1.20%**

The ten largest holdings in Berenberg-1590-Aktien Mittelstand

Wirecard AG	3.89%
Grenke AG	3.66%
Norma Group SE	3.59%
Stabilus S.A.	3.52%
XING AG	3.48%
Ströer SE & Co. KGAA	3.44%
Nemetschek SE	3.35%
CTS Eventim AG & Co. KGAA	3.33%
Rational AG	3.30%
Dürr AG	3.25%

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Past performance is not a reliable indicator of future performance. There may be securities and account costs which additionally impact on value development.
(As at 1 March 2017)

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