UBAM – GLOBAL CONVERTIBLE BOND

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws. The classification of the fund(s) as per the Sustainable Finance Disclosure Regulation (SFDR) is available on ubp.com or in the latest prospectus.

Market Comment

- Q4 2022 was characterized by a further slowdown in global growth and emerging signs of peaking inflation across developed economies. During the fourth quarter of the year, the Federal Reserve had been sending signals to prepare the market for a slowdown in the pace of rate hikes and, after four consecutive 0.75% hikes, it rose its key rate by 0.50% in December. The Federal Reserve increased its policy rates totaling a 125bps hike from 3%-3.25% to 4.25%-4.50%. In the meantime, the European Central Bank and the Bank of England rose their rates by 125bps and 100bps to 2.50% and 3.50% respectively. Central banks' focus is currently on the labour market that remains too tight. In this context, risky asset strongly rallied in October and November before going through a tumultuous December. Over the quarter, the US 10-year rate rose by only 4bps to 3.87%. Despite the return of volatility during December, global equity markets ended Q4 in positive territory. Credit spreads tighten during Q4 for both IG and HY down by 29bps and 64bps respectively.
- Eventually, global equities ended the quarter up 9.8% (MSCI World TR), bringing their performance over 2022 to -18.1%. In the US, the S&P 500 index increased by 7.6% quarter-on-quarter; cross-Atlantic, the Stoxx Europe 600 index was up 10% q/q and the Nikkei 225 index also ended the quarter in positive territory, up 0.8% q/q (all performance expressed in local currencies). In terms of investment styles, there was an outperformance of the Value segment over the Growth (13.6% q/q for the S&P Growth index, 12.2% ahead of the S&P Value index). US Quality small cap was in between with the Russell 2000 Quality moving 9.3% higher.
- In this context our asset class exhibited an encouraging behavior showing its capacity to both rally when market environment improves and to mitigate downside risk.
- Primary market confirmed the rebound seen in Q3 as global markets introduced $13.2 billion of convertible bonds during the last quarter of the year. The US contributing $8.9bn, Europe $3.0bn and Asia $0.9bn and Japan $0.3bn. After two record years of issuance, the decline in 2022 was sharp. Overall, in 2022, global convertible issuance is still relatively low and totalized $39bn including $28.5bn in the US, $6.2bn in Europe, $4.2bn in Asia and $0.4bn in Japan.

Performance Review

- Global convertible bonds (represented by the Refinitiv Global Convertible Bond index hedged in Euro, “the index”) returned 2.1% q/q. With a net return of 3.4% in Q3, the performance of the UBAM – Global Convertible Bonds (IC EUR share class) was ahead of its universe. Region-wise, all regions contributed positively, but most of the performance has been driven by our investment in the US. In terms of sectors, all sectors ended the quarter with a positive performance, with the exception of Utilities. Healthcare, Consumer Discretionary and Technology were the main contributors to the strategy’s performance. At issuer level, top absolute contributors in Q4 include China Yuhua education (China Consumer Discretionary, closed in October), Dexcom (US Healthcare), and Halozyme (US Healthcare). Main detractors were Lumemtum (US Technology), Datadog (US Technology) and Zscaler (US Technology).
- In 2022 our global flagship strategy, UBAM – Global Convertible Bonds shows a net performance of -20.5% in Euro.

All performance figures are given net of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Portfolio Activity

- At the end of December, the average equity sensitivity of UBAM – Global Convertible Bond stands at 33.1% (+3.9q/q), 0.7pts below its index. The strategy's interest rate sensitivity moved slightly lower, at 1.7 for a 2.9-year duration. The average credit spread of the portfolio decreased by 77bps over the quarter and our credit profile remains very solid at 204bsp and lower its index, 397bps.
- From a geographical standpoint, the fund is primarily exposed to equity markets through investments in the US (23.4%). Investments in Europe account for 6.7% and Asia and Japan for 1.2%. Relative to the index, the portfolio exhibits an average overweight stance to Europe (+2 pts equity sensitivity) and an underweight to the US (-0.4pts) and less exposed to Asian (-3.2pts) markets.
- After the repositioning of the portfolio focused on "quality" companies over the previous quarter, trades mainly involved adjustments to adjust risk. We have continued to consolidate the positions in the healthcare and industrial sectors. This came with the reduction of our exposures to Information Technology and Consumer discretionary names. We increased our positions in Qiagen and Jazz Pharmaceuticals, two stocks in the healthcare sector. We also took our last profits on Twitter convertibles, at a price close to parity given Elon Musk's acquisition of the company. On the primary market we participated in two European issues, Ubisoft 2.375% 2028 and the GBL exchangeable into Pernod Ricard 2.125% 2025. We initiated positions in Ziff Davis and Bentley Systems, two strong technology companies. In December, we bought the new Iberdrola 0.5% 2027 and switch part of our positions on Nextera Energy Partner into the new, more defensive 2026 2.5% coupon notes. The other major event of December in our strategies was the announcement of the early repayment by Engie of its GTT exchangeable bond. We therefore sold our entire position in this name, one of the best contributors to the performance of 2022, in December.

Outlook

- The year 2022 will be remembered for the sharp rise in short and long rates that penalised all asset classes. Although several developed economies are on track to experience further economic weakness this year, recent evidence suggests that the overall impact could be smaller than previously anticipated. Overall, we do not anticipate a collapse in global growth given the strength of labour markets within developed economies, whilst Asian countries should provide support to the growth backdrop amid Chinese reopening. 2023 should see a lull in the rise in short rates, while maintaining strong tension on long rates. Markets are likely to be less directional and less adverse. Dispersion could be particularly high in the equity markets and 2023's expectations are starting to reflect downward earnings revisions that could lead to an extended period of volatility.
- In this context, convertibles are clearly in better shape, and we focus on quality companies from both credit and fundamentals standpoints. The secular growth bias of our market should be supportive, thanks to reduced upside pressure on interest rates in 2023 and attractive valuations at current level. In the wake of the market correction, companies issuing convertible bonds suffered a massive de-rating since their valuation peak in 2021. They now appear more attractive given still strong fundamentals and growth prospects. At this level, it is an opportunity for investors to rebuild exposure on equities through convertible bonds considering the potential offered by the embedded option trading significantly out of the money.
- After being negative for a while, yield in the convertible universe has now moved into positive territory. Close to 50% of the convertible bond universe offers a yield >5%. This constitutes a return driver that has been missing for a several years.
- Convertible bonds underlying equities are not expensive anymore and yield is back in the convertible bond universe. As a result, the outlook for convertible bonds is positive thanks to restored multiple performance drivers: underlying equity upside potential, yields and credit.

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