
# UBAM CONVERTIBLES GLOBAL

Quarterly Comment | Q4 2019

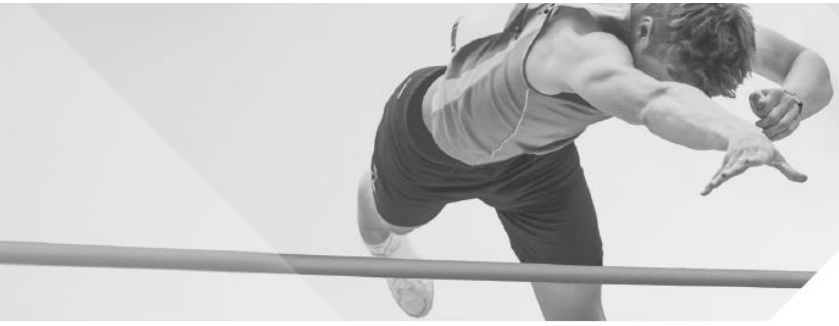
For Qualified Investors in Switzerland or Professional Investors or Eligible Counterparties as defined by the relevant laws.

## *Market Comment*

- The prospect of an agreement between the US and China, the clear result in the UK elections and a healthy macroeconomic environment helped restore confidence and supported risk assets in Q4.
- In the US, the S&P 500 TR progressed by +9.1% q/q; in Europe, the Stoxx Europe 600 NR climbed +6.1%; in Japan, the Nikkei 225 TR ended up +8.9% and the Hong Kong HSI (TR) finished up +8.9% q/q. Performance was even stronger in Emerging markets, with the MSCI Emerging Markets equities index up +12.2%.
- Sector-wise, the rotation that had hit the market end-Q3 continued in Q4. Backed by sound GDP growth prospects, cyclical names outperformed growth and defensive ones. In this context, the healthcare and technology sectors yet managed to rebound from their Q3 weaknesses.
- Volatility slightly decreased over the quarter – whilst remaining quite sustained. At December-end, the fear-gauge index (VIX) settled at 14pts (from 16pts at the end of September); in Europe, the V2X index closed at 14pts (from 16pts at September-end).
- On the sovereign bond side, the 10-year yields closed higher: by +25bps q/q in the US, up to 1.92%, and by +39bps in Germany (at -0.18%).
- The high yield segment and, though to a lesser extent, investment grade corporate debt in the US, benefited from credit spreads tightening. 3-5Y high yield (HY) indices were up +2.61% in the US and up +1.98% in Europe, while 3-5Y investment grade (IG) indices were up +1.08% in the US and slightly down in Europe (-13bps).
- Convertible bonds issuers continued to raise capital opportunistically during the last quarter of the year, with a peak in October. They took advantage of supported volatility, tight credit spreads, and near all-time high stock prices.
- In Q4 2019, global primary issuance amounted to USD 14.2bn, bringing YTD total to USD 85bn. Region-wise, the US market was the main contributor to past quarter's activity, bringing USD 8.7bn of new papers. On their end, Europe, Asia (ex-Japan) and Japan contributed respectively USD 2.7bn, USD 2.2bn and USD 0.6bn.

*Sources: UBP, Bloomberg Finance LP, BofA Merrill Lynch.*

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.





## *Performance Review*

- UBAM Convertibles Global ended the quarter up +3.67% after fees (-1.10% beyond the Thomson Reuters Convertibles Global EUR Hedged index*), bringing its year-to-date performance up to +11.26% (vs. +14.45% for the index*).
- In Q4, the equity bucket was the main contributor (+4.09%). The optional features and fixed income bucket contributed positively as well, respectively by +20bps and +9bps. On their hands, Forex (hedging and implied forex) and “others” (management & trading fees) cost -40bps and -32bps respectively.
- Region-wise, the portfolio’s exposure to the US market added the most to performance (+3.29%), followed by Europe (+68bps), Asia ex-Japan (+29bps) and Japan (+14bps).
- At firm-level, major contributors to performance this quarter were AMD (+30bps, US Semi-Conductors), Sarepta (+26bps, US Biotech) and RingCentral (+26bps, US Communications). On the negative side, main detractors were Wayfair (-13bps, US Communications), Twilio (-6bps, US Communications) and CYP exchangeable in CCB (-6bps, Hong Kong Financial).
- In comparison to the index*, the underperformance of the strategy over the quarter was driven by two main factors: the sector rotation that led to the relative outperformance of value names, especially in the high yield segment to which we are less exposed in line with our investment philosophy, and our stock picking.
- Our underexposure to the Consumer Cyclical, the Industrial and the Basic Materials sectors cost us respectively -64bps, -23bps and -17bps q/q. At companies level, we mainly suffered from our absence from Tesla (-60bps, Consumer Cyclical). Tesla stock rallied during the period and the convertible bond is largely represented in our universe. However, we do not hold the name in accordance with our cautious credit stance, at the core of our process. On the positive side, overweighs in RingCentral (+18bps), Neoen (+16bps, France Energy) and Lumentum (+14bps, US Technology) proved favorable.

## *Portfolio Activity*

- Mainly driven by the strong equities’ performance over the last months, the average equity sensitivity of the portfolio increased over the quarter, ending at 47.2% (+6.6pts q/q).
- Region-wise, at December-end, the portfolio’s equity exposure is split as follow: US 28.6% (+3.6% q/q); Europe 12.5% (+1.4% q/q); Asia 4.14% (+89bps q/q); Japan 2% (+82bps q/q).
- The average interest rate sensitivity of the portfolio decreased over the quarter, ending at 1.84% with a duration of 3.9 years. At December-end, the average OAS spread of the portfolio settles at 187bps compared to 288bps for the index*. This gives strong evidence of our focus on credit quality in our security selction.
- With near-term risks still at play, we maintained a disciplined approach in terms of profit-taking and rebalancing of our portfolio towards convertible bonds with more balanced equity profiles. This was done whilst keeping core attention to the credit quality. This should remain at the core of our approach in the coming months.
- Thus, over the past quarter, we took profits out of very equity-like profiles – such as Wellpoint (US Healthcare), Intel (US Semiconductors), or AMD – and reinvested the proceeds in names with more balanced profiles and strong credit quality such as Cembra (Switzerland Financial) or Stanley Black (US industrial).
- In Europe, we also participated in the new Neoen 2024 (France Energy) as well as in the new Atos/Worldline 2024 exchangeable (France Technology). Both offer good balanced profiles and strong earnings’ growth prospects.

* For information and comparison purposes only. The fund has no official benchmark.

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*Outlook*

- With good GDP growth driven by a healthy labor market and consumer spending, low absolute rates, accommodative monetary policy and benign inflation, the global picture remains supportive of risk assets for 2020. Investors are thus expecting a healthy year, backed by earnings growth rather than multiples expansion.
- Even though the broad economic outlook points toward a robust economy, we remain vigilant about some unpriced geopolitical risks such as Middle East tensions, US elections, China/HK conflict or Brexit – to name but a few.
- In 2019, we note that global convertibles' performance was led by names in the Technology space, high delta profiles as well as by high yield/Non rated names. Heading into 2020, we believe that the long-term outlook of companies in the Technology and Healthcare sectors should remain supported by favourable secular trends (e.g. digitalisation of the economy, middle class consumption in Asia, healthcare, etc.) and thus top line growth. In this context, we expect to remain selectively more exposed to growth names in the US, with our regional diversification providing sector diversification.
- The bias in favor of value names seen in the market over the past 5 months is likely to remain in play in 2020, backed by more robust manufacturing activity. That said, names in the convertible bonds' "value" space are not necessarily our "top picks" due to a weaker operational and credit profile of the issuers. From a valuation and fundamental point of view, we thus remain comfortable with our constructive stance towards quality and growth names.
- In light of the lingering uncertainties that offer potential for sustained volatility in the months to come, we will maintain a disciplined approach in terms of profit-taking.
- Similarly, we remain very selective with respect to the recent primary activity given the opportunistic approach of many issuers. However, we do not shy away from opportunities to rotate away from equity sensitive structures into instruments with more balanced risk-reward profiles.
- While remaining reasonably constructive on equity markets, we expect 2020 to be challenging given the many upcoming events and the lack of visibility on the geopolitical front. This, combined with interest rates at historical lows and tight credit spreads, leads us to believe that convertibles remain an asset class of choice for the year ahead.
- We will maintain our rigorous process to investing in regards to good credit quality and robust risk management in combination with conviction based positioning; a combination that we believe remains particularly adapted to current market environment.

## Disclaimer