THE DRIVE YOU DEMAND

UBAM CONVERTIBLES GLOBAL 10-40

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 10-40 ended the quarter up +1.56% after fees, underperforming the Thomson Reuters Convertibles Global Focus EUR Hedged index* by -2.9%. YTD, the strategy is up +5.98%, which compares to a return of +10.11% for the index*.
- During the quarter, the underlying equity component was the main driver to performance for the strategy (+2.5%). The optional features contributed positively as well, adding +41bps. In contrast, with risk free rates slightly rebounding, the fixed income bucket cost -38bps. Forex (hedging & implied forex) and “others” (management & trading fees) also detracted, by -40bps and -58bps respectively.
- Region-wise, the portfolio’s exposure to the US contributed the most, +1.84%. Exposure to all other regions also added to performance, Asia brought +45bps, Japan +18bps and Europe +7bps.
- Over the quarter, sectors that contributed the most were Technology (+1.47%), Consumer Non-cyclical (+45bps) and Communications (+36bps). On the negative side, detractors were the Financial (-12bps), the Utilities (-9bps) and the Energy (-0.4bps) sectors.
- At firm level, major contributors to performance in Q4 were Lumentum (+44ps, US Technology), On Semiconductor (+36bps, US Technology) and Splunk (+27ps, US Technology). On the other hand, our investments in Twitter (-20bps, US Communications), Ubisoft (-17bps, France Technology) and Akamai Technologies (-12bps, US Technology) were the main detractors.
- In comparison to the index*, the underperformance of the strategy over the quarter was driven by our stock picking. We mainly suffered from our absence from Tesla (-1.27%, 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, our underweights in United Microelectronics, Wirecard and Wayfair proved favourable, adding respectively +19bps, +18bps and +17bps.
- Sector-wise, our underexposure to the Consumer Cyclical (that contains Tesla), the Financial and the Communications sectors cost us respectively -1.35%, -36bps and -31bps.

Portfolio Activity

- Mainly driven by the strong equities’ performance over the last months, the average equity sensitivity of the portfolio increased during the quarter, from 31.05% up to 38.96% at the end of December (a level in line with the index*).
- Region-wise, at December-end, the portfolio’s equity exposure is split as follow: US 21.34% (+7.65% q/q); Europe 10.15% (-1.2% q/q); Asia Pacific 3.94% (+13bps q/q); Japan 3.54% (+1.33% q/q).
- The average OAS spread of the portfolio decreased quarter-on-quarter, settling at 142bps, which compares to 210bps for the index*. This gives evidence of our focus on higher credit quality names.
- Over the quarter, the fund’s asset under management decreased significantly. Therefore, we closed several positions, decreasing these from 99 to 52.
- We closed our positions on convertibles such as NXP Semiconductor 2019, Extra Space Storage 2035 or Akamai Technologies 2025. And rebalanced our portfolio towards strong convex profiles, thus increasing weights on convertibles such as Adidas 2023, the CYB exchangeable in CCB and maturing in 2021 or Splunk 2023.

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

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.

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