

# UBAM - EUROPE MARKET NEUTRAL

## Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws

### Market Comment

- After a strong Q2 with widespread positive performance, the third quarter of 2020 shows regional disparities reflecting the local evolutions of Covid19. Indeed, as the different containment strategies yield their results, the spread of the virus is not uniform across countries and stimulates a range of economic responses – resulting in different market performance between regions. The gap between growth and value stocks also persists as growth companies are up +19.2% year to date while value is down -14.1%, in Europe. A cold winter without enough positive vaccine development news would be negative for value stocks and widen the gap further.
- In year to date terms, the S&P500 is the leading index with +5.6% return followed by MSCI EM with flat performance and ahead of the MSCI Europe ex-UK index displaying -7.4% returns. The lack of progress of Brexit negotiations and the fading fiscal stimulus causes the UK to lag, with the FTSE All-Share down -19.9%. Following the Internal Market Bill which seeks to modify the terms of trade between the UK and Northern Ireland, the most likely Brexit scenario is a limited free trade agreement with significant arrangements to ease the transition.
- While hospitalisations in Europe and the UK seemed under control during the summer, the effect of travelling abroad for the holiday season led to a new rise in the number of cases – most notably in Spain, France and the UK. This fuelled concerns that dropping temperatures in Autumn could lead to a second wave of Covid19 and caused European equity markets to lag as the MSCI Europe ex-UK index returned +1.8% and the UK FTSE All-Share was down -2.9% this quarter. The worsening sentiment is also displayed by volatility levels – the VIX index has increased to the 25-35 range during September compared to the 20-25 levels in June and July.
- The United States experienced a rise in cases at the start of Q3 but thanks to the use of face masks was able to reduce hospitalisations significantly from the end of July. Combined with the transition to online commerce, this resulted in strong performance from US technology and growth companies for most of the quarter. Unemployment also displayed a modest reduction, but as valuations expanded and the risk for a vaccine-driven rotation increased in September, the market slowed down to favour cheaper stocks. This resulted in a quarterly return of +8.9% for the S&P500.
- Overall, an undeniably uneven quarter, but investors will now prepare for an eventful end to the year – the US election outcome will soon be known, a Brexit scenario will be determined, and news on a potential vaccine could accelerate – which would be a game-changer for the market and help many stocks that have lagged throughout the year recover.
- Looking through industry indices, there has been lots of dispersion among European Equity Market Neutral Ucits competitors and many funds have suffered, despite their market neutral approach. In this context, the fund has shown outstanding performance versus peers.

\*All indices are total return in local currency, except global ones in US Dollars.

## Performance Review

- In the third quarter of 2020, UBAM - Europe Market Neutral returned +3.8% (Class I EUR), comparing favorably with the HFRX Equity Market Neutral Index (hedged in EUR) and the EuroStoxx 50 Index (total return) that returned -1.9% and -0.8% in Q3 respectively.
  - ▶ In terms of quarterly contribution, our Long bucket contributed positively +3.7% (gross of fees) to the overall portfolio, generating a positive alpha of +4.2% versus the beta-adjusted Eurostoxx 50 TR (SX5T) reference. The Short bucket detracted +0.5% (gross of fees) on an absolute basis, but generated an alpha of -1bps.
- On a YTD basis through September, UBAM - Europe Market Neutral returned +10.9% (Class I EUR), comparing favorably with the HFRX Equity Market Neutral Index (hedged in EUR) and the EuroStoxx 50 Index (total return) that returned -6.5% and -12.5% in 2020 respectively.
  - ▶ In terms of YTD contribution, our Long bucket contributed positively -0.2% (gross of fees) to the overall portfolio, generating a positive alpha of +9.6% versus the beta-adjusted Eurostoxx 50 TR (SX5T) reference. The Short bucket contributed +12.1% (gross of fees) on an absolute basis, but generated an alpha of +2.3%.
- Within the Long book:
  - ▶ The quarterly alpha of the long book was a result of overweight positions in Information Technology and Industrials as well as an underweight in Financials, Consumer Discretionary and Healthcare.
  - ▶ In terms of specific stocks positions, significant positive outperformance was recorded in Kingspan (Industrial), Neste (Energy), Infineon (Technology), CNH (Industrial) and Schneider (Industrial). On the other hand, Allianz (Financials), ASM (Information Technology), ATOS (Information Technology), Wordline (Information Technology), ACS (Industrials) underperformed the main Eurostoxx reference on a relative basis.
  - ▶ Overall, our Long book significantly outperformed the EuroStoxx 50.
- Within the Short book:
  - ▶ Short Bias, which represents 85% of the overlay allocation and is implemented via both futures and options on the Eurostoxx 50 Index most liquid contract, brought some positive contribution during the quarter. It brought some alpha compare to its benchmark as well. The allocation was positioned defensively on average during the quarter. This was compensated by the relatively high level of volatility that allowed the options positions to perform well .
  - ▶ Tail Risk represents the remaining 15% of the overlay allocation and is implemented via front-contract VStoxx volatility futures. The strategy suffered in July and September when the market was going down and the volatility did not react. However, the strategy brought some alpha in August when the allocation to volatility futures was minimum and the equity market was going up.
  - ▶ Overall, our Short book was in line with its reference.

\*Index provided for comparison and information purposes only. The fund has no official benchmark.

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## Portfolio Activity

- UBAM – Europe Market Neutral combines two alpha generating engines in a single systematic investment process. The long leg is invested in the AM League Euro 50A© Index, which is based on best ideas from top-performing buy-side managers and is rebalanced on a quarterly basis and weighted according to conviction. The short leg is comprised of a dynamically managed short index overlay, which uses ultra-liquid index futures and options and volatility futures. UBAM has partnered with AM League to launch this innovative investment solution to capture this alpha.
- Overall, our long book positioning during the third quarter was slightly more defensive than the market, with a beta of the long book of approximately 0.87, a one-way quarter-on-quarter turnover of 50% and estimated active share of 70% vs the EuroStoxx 50.
  - ▶ In terms of sectors, the largest allocations were in IT (27%) and Industrials (23%), all representing significant overweights versus the EuroStoxx 50 at the expense of underweights in sectors such as Financials and Consumer Discretionary.
  - ▶ In terms of countries, the largest active bets were notable underweights in Germany and France with a corresponding overweight in Ireland.
  - ▶ The portfolio is relatively skewed towards large rather than mega-cap, with an average market cap of 44bn vs 83bn for the EuroStoxx 50.
  - ▶ Looking at single stocks, the top 5 positions were ASML (Technology), Kerry (Consumer Staples), Iberdrola (Utilities), Schneider (Industrials), and Allianz (Financials). When compared to the EuroStoxx 50 constituents' weights, the largest over/under weightings were Kerry (o), Kingspan (o), CNH (o), SAP (u), Puma (o). Some of stock picks have membership in the wider EuroStoxx 300 only.
- Within the Risk Management Overlay bucket, trend signals used in the Short Bias strategy began the quarter with a bearish positioning. Signals were less bearish in August and until the end of the quarter but remained bearish overall.
  - ▶ Within the Tail Risk bucket, the exposure to volatility futures was high at the beginning of the quarter, but quickly decreased to minimum of exposure in early July. It remained stable at minimum exposure until the end of the quarter.
- In terms of currency exposure, the portfolio remains 100% invested in EUR.

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## Outlook

- Given where we are in the cycle, an equity market neutral product should appeal to many investors, with very low correlation to traditional assets and absolute returns. UBAM – Europe Market Neutral combines two complementary systematic strategies that may generate value both on the long side and the short side in a single daily liquid UCITS EUR-based fund.
- The AM League methodology is fully transparent, but their underlying database is proprietary, with alpha capture mainly driven by their capability to access portfolios of best ideas in a way that isn't available to other players. For example, European carve-outs of global unconstrained (buy-side) portfolios with high active share.
- On October 5<sup>th</sup> 2020, the long book quarterly rebalancing triggered a significant sectorial reduction in Information Technology and Industrial in favour of Consumer Discretionary and Financials. New top stock picks are Teleperformance, Intesa San Paolo, Moncler, Covestro and Signify.

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