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

- The third quarter of the year has been characterized by a slow return of volatility on the back of rising bond yields, concerns regarding the return of inflation, Chinese economy difficulties and global macroeconomic environment deterioration. Economic surprise indices have been falling significantly over Q3. Nevertheless, the economy, especially in the US, still appears robust enough, therefore central bankers maintained their hawkish stance and reiterated that interest rates will stay high for a prolonged period. The Federal Reserve hiked its policy rate only once by 25bps over the quarter to 5.5%. The ECB increased its policy rates twice in July and September bringing the deposit rate to 4% from 3.5% and the refinancing rate to 4.5% from 4.%. however, ECB statement leads to believe it is likely that the September 2023 hike was the last in the eurozone. Over September, the “*Higher for Longer*” rhetoric kicked in and we saw a sharp steepening of the US yield curve, with the 10yr and 20yr yields moved 73bps and 88bps higher at 4.57% and 4.91% respectively while the 2yr was up only 15bps at 5.04%. Equities started to sell-off that over August and this has continued in September, and Growth companies suffered the most.
- Major equity markets were under pressure over the third quarter of the year and global equities ended the quarter down 3.0% (MSCI World TR). In the US, the S&P 500 index decreased by 3.6% quarter-on-quarter; cross-Atlantic, the Stoxx Europe 600 index was more resilient being down only 2.1% q/q and the Nikkei 225 index moved lower by 3.4% q/q (all performance expressed in local currencies). In terms of investment styles, there was an outperformance of the Growth segment over the Value (-2.9% q/q for the S&P Growth index, -4.6% ahead of the S&P Value index). US Quality small cap performed better with the Russell 2000 Quality moving only 2.2% lower.
- Being down 1.9%, convertible bonds exhibited an encouraging behavior showing its capacity to mitigate downside risk.
- Primary market has continued to be strong with $21.5bn issued over the third quarter. The US contributing $13.5bn, Europe $3.2bn, Asia $3.3bn and Japan $1.4bn. This brings the year-to-date issuance volume to $65.5bn. H1 2023 issuance has reached $40bn. This is in line with pre-coved trend ($76bn issued annually between 2010 and 2019).

Performance Review

- Over Q3, UBAM – Global Convertible Bonds (IC EUR share class) posted a net return of -4.2% bringing the year-to-date performance to -1.6%. This is behind its Global convertible bonds universe (represented by the Refinitiv Global Convertible Bond index hedged in Euro, “the index”) which returned -1.9% q/q and +5.0% since the beginning of the year. Most of the underperformance is coming from the US region. During Q3 the renewable energy sector, solar theme specifically, has been significantly under pressure on the back of the strong rise in long-dated yield. We were exposed to this theme through Nextera Energy Partner, via two convertible bonds. Our helathcare exposure, especially in the Diabetes & Obesity related businesses (Insulet and Dexcom) weighed on our performance.. At issuer level, top absolute contributors in Q3 include Akamai (US Software & Services), Booking (US Consumer Services), and Macom (US Semiconductors). Main detractors were Ford (US Auto & Components), Nextera Energy Partners (US Utilities) and Dexcom (US Health Care Equipment).

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 September, the average equity sensitivity of UBAM – Global Convertible Bond stands at 36.9% (-5.8q/q), inline with its index. The strategy's interest rate sensitivity moved slightly higher, at 1.7 for a 3.2-year duration. The average credit spread of the portfolio remained relatively stable over the quarter and our credit profile remains very solid at 211bps and lower its index, 336bps.
- From a geographical standpoint, the fund is primarily exposed to equity markets through investments in the US (22.4%). Investments in Europe account for 9.1% and Asia and Japan for 3.9%. Relative to the index, the portfolio exhibits an average overweight stance to Europe (+4.9 pts equity sensitivity), while slightly overweight with the benchmark's US exposure (+0.8pts) and less exposed to Asian (-1.9pts) markets.
- We have been reconsidering slightly our positioning regarding credit exposure over the quarter, adding "carry" & duration in a contained manner. We increased exposure on credit in the consumer discretionary and healthcare sector, where we identified companies with high performance potential that should not be overlooked (especially in case of M&A). Therefore, we are selectively investing across this bucket in a well-diversified manner in order to limit the idiosyncratic risk. We increased the number of positions in portfolio moving from 83 to 122 holdings. We participated to several new deals supported by a busy primary market. In Europe, we participated to the Saipem 2.875% 2029 and to the ENI 2.95% 2030 issues, both in the energy sector. In Japan, while Daifuku issued two convertibles, we participated only to the 2030 maturity. On the US market we participated in the Shockwave 1% 2028, a vascular-focused medical device company, to the Workiva 1.25% 2028, a cloud native software company focusing on regulatory, financial, and non-financial (ESG) reporting workflow automation, and to Seagate 3.5% 2028, a leading provider of data storage technology and IT infrastructure solutions.

Outlook

- Economic indicators in Europe have stabilized, but PMI indices are still under 50, indicating contraction in economic activity. We currently don't see any contagion to the real economy and the labor market is strong as unemployment is at is 30-year low.at 6.4%. In the US, the economy continues to be strong with industrial production and consumption data release stronger than expected, and labor market remains tight. To our view, central banks are approaching the end of their hiking cycle and with growth holding up, we still expect the US economy to avoid a hard landing in 2024. Global markets and especially equities have undergone a correction from year's high on the back of the back of the sharp upward move in long-dated yields amid a "higher for longer" rhetoric from central banks. Valuation re-pricing have put pressure on equities in the short-term, especially on sectors that are leveraged (Utilities, Telecoms and Real Estate) or not sufficiently profitable (Renewables, High Growth Tech). We see this correction as technical and provide opportunities for long term investors especially in the Healthcare and Technology sectors. With Credit Spread below historical average, we stay selective in our name selection and favor IG-like exposure for the attractive carry.
- In addition, the primary market is expected to continue picking up, fueling a new dynamic of attractiveness to the asset class. Deal terms have been more favorable with higher coupons and lower premiums. We also welcome the return of Investment Grade issuers and more diverse type of companies from a sector basis. YTD we have seen more Utilities and Industrials, and less Technology and Consumer Discretionary names when compared to the last 5 years.
- Over the medium-term convertible bonds have the potential to deliver better risk-adjusted returns. Furthermore, we recently noticed a decrease in convertible bonds valuation, more pronounced in the balanced segment of the universe, which offers a good entry point in term of convexity. Given current volatility, convertible bonds offer portfolio diversification and allow investor to maintain an exposure to the equity market while containing its downside risk.

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