U ACCESS – CHINA 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

- Beijing announced it was rapidly pivoting away from its “Zero-Covid” strategy in December. Restrictions, tests, and quarantine requirements have been eased in December and then early January, travel restrictions have been dropped. As a result, Chinese economy is reopening much quicker than anticipated and this will have a material positive impact on domestic growth. Retail sales rebounded strongly in Jan-Feb, reaching 3.5% YTD y/y and are no longer negative. Industrial production recovered to 2.4% YTD y/y. Purchasing Manager indices for both manufacturing and services are above 50 indicating expansion in economic activity. In this context, risky assets have continued their rally started at the end of last year.
- For the quarter ending 27th March 2023, China’s domestic stock market (hereafter the “A-share market”) rose by 4.2% (CSI 800 Total Return Index). For purpose of comparison, over the same period, Hong-Kong-listed mainland securities (the Hang Seng Index, HSML100) was down -3.3% (CNH, total return).
- Over the past three months, the top 3 performing sectors of the A-share market were Computer (+37.63%), Media (+34.49%), and Telecommunication (+31.42%). At the bottom-end, Social services (-0.60%), Electrical Equipment (-0.86%) and Commerce (-4.39%) reported the most negative returns q/q (based on ShenYin WanGuo classification).
- During the quarter, convertible bond issuance in domestic China totalled CNY 20 billion through 12 new convertible issues. At March-end, they are 482 convertible bonds in the Chinese onshore market, for a total outstanding amount of CNY 1,016 billion. Sector wise, the financial sector (banks and non-banks) still represents the largest share of the region convertible universe.

Performance Review

- In Q1, the strategy increased by 4.6% (U Access – China Convertible Bond IC CNH), outperforming its investment universe[1] by 1.8%. Such outperformance is explained by sector allocation and the bond selection. Sector-wise, the alpha of the strategy in Q1 came primarily from its investments in Banks, Construction & Decoration and Pharmaceutical and Biotech. On the opposite-end, Light Industry Manufacturing, Environmental Protection and Machinery Equipment had negative impacts.
- The Chinese equity market rose over the quarter on the back of a rebound in economic activity and a consumption recovery, being up 5.3%. Over the same period, the on-shore convertible bond market (CSI Convertible Bond Index) moved up by 3.3%.

Portfolio Activity

- The investment level of the U Access – China Convertible Bond portfolio remained above 95% for the whole period under review. In comparison to the investment universe, we maintained an underweight exposure to the Financial sector in accordance with our systematic approach which aims to ensure sufficient portfolio diversification. For purpose of indication, the portfolio’s exposure level to the Financial sector was slightly below 20%, compared to an average weight of 35% for the universe. Likewise, the cumulative weight of the portfolio’s top 10 holdings remained below 13% (vs. 31% for the investment universe).

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.

- In terms of risk profile, throughout the quarter, the portfolio maintained greater allocation to both the “balanced” and “higher equity sensitivity” segments than the investment universe, and an underweight positioning to the “bond-like” segment.
- At December-end, the portfolio exhibits an average equity sensitivity of 64.9%.

Outlook

- We expect a sequential acceleration to around 4.0% in Q1-23, up from 2.9% in Q4-22. Positive base effects should result in outperformance in Q2-23. Above potential growth will likely remain in place into H2-23. Overall, UBP expect GDP growth to rebound and accelerate over the year to reach 6.0% for 2023, on the back of a rebound in economic activity supported by three positive catalysts: 1) Chinese economy reopening, 2) housing sector should be a smaller drag in 2023 and 3) A sizeable pile of excess savings may find its way into additional consumption in 2023. This combined with the continued loose financial conditions provide strong tailwinds for Chinese assets and investor sentiment.
- A-share equities are still trading at a 5Yr Cyclically Adjusted Price-to-Earnings ratio attractive level of 13.8x (vs. 15.5x historical average). To our view this could represent an attractive entry point for long term investors. However, the high volatility associated with A-shares has historically been a drawback when considering exposure to onshore China. Thanks to their dual nature, convertible bonds give investors access to A-shares with lower volatility and reduced drawdown risk.
- The Chinese onshore convertible bond market offers access to companies and sectors with a direct or indirect exposure to the growing Chinese consumer’s demand. In our view, these constitute a fertile hunting ground as China moves to its era of “common prosperity”.
- Our U Access – China Convertible Bond strategy follows a systematic selection & allocation approach. The latter has been designed to provide investors with a liquidity-enhanced and diversified exposure to China’s on-shore convertible bond market, which is capable of navigating the A-share market’s bouts of volatility, as evidenced by the outperformance achieved by the strategy since its inception compared with both the equity market and the convertible bond universe.

[1] Investment universe = internal indicator corresponding to all outstanding Chinese onshore convertible bonds eligible to the strategy’s investment criteria, weighted by their outstanding size. For indicative purpose only, the strategy has no official benchmark.

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