Q1 2021

UBAM – EUROPE 10-40 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

- Reflationary pressures and cyclical rotations dominated markets' news flow in Q1, in the wake of a broad acceleration in the covid-19 vaccination campaigns rollout and the prospect of massive stimulus in the US.
- Altogether, these factors triggered a sharp rise in long-term rates (10-year Treasury yields up +80bps q/q in the US, +28bps q/q in the Eurozone) and noticeable sector performance dispersion on equity markets to the detriment of 2020's biggest "winners" (tech and growth). After a strong start into the year, the cyclical rotation weighted down on the performance of convertible bonds, due to the large share of higher growth companies in the asset class' universe.
- Region-wise, on global equity markets, the outperformance of value and cyclical names largely benefited European stocks which posted strong gains in Q1. The Stoxx Europe 600 index closed the quarter up 7.4%, +1.5% ahead of the S&P 500 index and +1.4% ahead of the MSCI World index (all indices hedged into euro). In Asia, the Nikkei 225 index closed the quarter up 6.3% (local currency).
- Global convertible bond issuance totalled over USD 62 billion in Q1, wrapping up the best start to a year on record. The vast majority came from the US (USD 44bn) followed by Europe (USD 10.5bn). Looking into details, Q1 new issues were primarily driven by companies in the tech (24%), consumer discretionary (20%), communication (15%) and healthcare industries (12%).

Performance Review

- UBAM – Europe 10-40 Convertible Bond ended the quarter flat (-0.09% after fees, IC EUR share class), outperforming the Refinitiv Europe Hedged Convertible Bond (EUR) ("the index"), by +0.35%.
- The performance of the strategy during the quarter deserves to be put in perspective with the cyclical rotation that has dominated global equity markets for the past five months. The « growth » bias of the convertible bond market was a clear performance engine last year, both in absolute and relative terms. With the ongoing rotation though, it is this very same bias that explains the recent lag of the asset class when compared to equity indices.
- In relative terms versus the index, however, our early decision to diversify part of our investments in favour of covid-19-recovery names proved beneficial and helped us mitigate the negative impact of the recent cyclical rotation.
- Sector-wise, it is therefore with no surprise that we find Industrials and Consumer Cyclicals in the top 3 contributors to the strategy's overall performance in Q1. At firm level, most performing investments include names such as Shop Apotheke, Airbus or Sika. More surprisingly, the Tech sector is also part of the top 3. Looking into details, this is explained by the robust behaviour of some of our strong convictions – BE Semiconductor topping the list. On the opposite-end, main Q1 detractors include "digital economy" names (Worldline, Ubisoft, Delivery Hero) as well as Puma and Adidas, as both companies suffered from China's government pressures on brands boycotting the use of cotton from areas suspected of using forced labour.

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

- During the quarter, the average equity sensitivity of the portfolio remained stable at around 42%, above that of the index (37% at March-end). The strategy's interest rate sensitivity remained contained and in line with its historical average level, at 2.5 for a 4-year duration. In terms of credit quality, as of March 31st, the portfolio exhibits an average credit spread of 144bps (-23bps q/q) vs. 192bps for the index. These levels reflect the "quality" bias inherent to our security selection process.
- With the overall sharp outperformance of the digital theme in 2020, our convexity-focused approach, combined with our wish to maintain a sound diversification in our portfolios, had led us to early take profits on our biggest "covid-winner" holdings, to the benefit of companies offering balanced convertible bond instruments including in the "covid-19-recovery" theme. We continued that process in Q1, focusing our selection on companies with robust balance sheet according to our analysis, and leading competitive positioning (e.g. Safran, Amadeus).
- Throughout the quarter we were active, though cautiously selective, in the primary market, participating in the new Voltalia 2025 (renewable energy), Shop Apotheke 2028 (online retail pharma) and JustEat-TakeAway 2025 (food delivery). Besides, we took advantage of the recent weaknesses in the digital space to strengthen some of our growth investments under more favourable pricing terms (e.g. STM, Zalando, Worldline, HelloFresh).

Outlook

- Besides the recent cyclical rotation, the case for convertible bonds remains strong. The convex nature of convertible bonds makes them compelling assets for those who wish to maintain an equity exposure whilst dialling back their risk a bit. In a context of near-record equity prices, elevated single stock volatility and lack of visibility as to when, and how fast, economies will reopen, an asymmetric equity exposure appears as a valid alternative to a full directional positioning. Convertible bonds' appeal is equally strong in a rising interest rates environment for those who wish to maintain bond-floor defensive features into their portfolio. Thanks to their conversion option, convertible bonds embed much lower sensitivity to interest rate moves than straight bonds of similar duration.
- Over the past fifteen months, convertible bonds' record issuance dynamism has sparked a broad deepening and renewal of the investment pool, led by "digital economy" and "covid-19-recovery" names. Thanks to their dual nature, convertible bonds give investors the chance to be actively positioned on both themes with much lower volatility along with significantly reduced downside risk than direct equity investments offer - an asymmetric payoff that was repeatedly demonstrated historically, and again over the past year.
- Overall, we see current cyclical rotation as an opportunity to tactically diversify our investments, rather than a questioning of our long-term quality-growth positioning. If anything, the pandemic has accelerated the spread of trends that were already in place before the covid-19 outbreak (digital transformation to improve business efficiency; cybersecurity to secure an ever-increasing number of online transactions; healthcare innovation to deal with the growing and ageing global population; etc.) and for which the long-term fundamentals remain unchanged – as confirmed by the large share of raised guidance amid the growth segment of the market during the recent earning session.
- Although we acknowledge the outperformance of cyclical and value companies in the shorter term, we remain cautious about the lack of visibility as to when and how fast their business activity can resume and return to pre-crisis levels. In this context, credit quality will remain a cornerstone of our security selection.

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