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

- For the quarter ended 30 September, major equity indices ended mostly flat as practically all the gains reported during the summer months were erased in the last two weeks of September amid a mix of concerns on China, inflation, and US tapering prospects.
- Eventually, global equities reported a timid rise of 0.10% quarter-on-quarter (MSCI World total return). In the US, the S&P 500 index closed the quarter up 0.58% and the Nasdaq 100 +1.09%. In Europe, the Stoxx Europe 600 progressed by 0.96% q/q. With a quarterly performance of +2.90%, the Nikkei 225 stood out (all performance expressed in local currencies). In terms of investing styles, the “Growth” play outperformed the “Value” overall, as revealed by the MSCI World Growth index up 84bps q/q, +149bps ahead of the Value index.
- Adding to September’s weaknesses on risk assets, the negative developments in large tech- and internet-related Chinese companies listed overseas, on top of heightened yield and credit spread volatility, weighted down on global convertible bonds’ performance in Q3. The Refinitiv Global Convertible Bond index (hedged in euro) declined 1.64% during the quarter.
- In the third quarter, global markets introduced $25 billion of convertible bonds with the US contributing $12 billion, Asia $6 billion, Japan $4 billion and Europe $3 billion. Year-to-date, global convertible bond primary issuance now amounts to $124 billion (incl. $68bn from the US, $28bn from Asia, $22bn from Europe and $6bn from Japan). At September-end, most of year-to-date new issues came from Consumer Discretionary (24%), Technology (21%) and Healthcare (10%) companies.

Performance Review

- For the quarter ended 30 September 2021, the UBAM – Global Convertible Bond sub-fund (IC EUR) returned -1.43% after fees, +21bps ahead of the Refinitiv Global Convertible Bond index (“the index”).
- Region-wise, our investments in Europe and Asia detracted overall whereas our selection in the US and Japan added value. In relative terms as well, our investments in the US drove the outperformance when the European bucket detracted.
- Sector-wise, the fund’s security selection in Information Technology and Healthcare were the main contributors to the strategy’s performance, both absolute and relative. Conversely, Consumer Discretionary and Communication concentrated the losses in absolute terms. Relative to the index, our selection in Financials and Consumer Discretionary came at a cost.
- Over the quarter, top absolute contributors include MongoDB (+42bps, US Information Technology), Sea (+32bps, Asia Communication Services) and On Semiconductor (+31bps, US Information Technology). Top detractors were Bilibili (-34bps, Asia Communication Services), WIX (-21bps, MEA Information Technology) and China Yuhua Education (-19bps, Asia Consumer Discretionary).
- Relative to the index, our overweighs in MongoDB, On Semiconductor and Atlassian (Asia Information Technology) drove the strategy’s outperformance, whereas overweighs to China Yuhua Education, WIX and Chegg (US Consumer Discretionary) came at a cost.

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 September-end, the average equity sensitivity of UBAM – Global Convertible Bond stands at 51.0% (-4pts q/q) roughly neutral with the global convertible bond market (51.6% for the Refinitiv Global Convertible Index). The strategy's interest rate sensitivity remains low, at 1.6 for a 3.8-year duration. The average credit spread of the portfolio remained stable over the quarter, closing at 212bps (from 214bps) versus 322bps for the index, reflecting the quality bias inherent to our philosophy.
- From a geographical standpoint, the fund is primarily exposed to equity markets through investments in the US (32%). Investments in Europe account for 12% and Asia and Japan for 5%. Other (MEA, South America) account for 1%. Relative to the index, the portfolio exhibits an average overweight stance to Europe (+4pts equity sensitivity) and an average underweigh positioning to the US (-4pts). In comparison to the US, the European market offers overall better credit profile on top of a differientating opportunity set, including in the higher growth segment: where the US is largely dominated by software companies, consumer discretionary businesses represent a noticeable share of the European's growth bucket.
- Despite the traditional summer lull, global convertible primary activity remained sustained in Q3, including from the part of repeat issuers. This allowed us to arbitrate some existing investments towards convertible bonds with more balanced profiles, therefor building up the overall convexity of the portfolio (e.g. On Semiconductor, Square) but also our exposure to high conviction names (e.g. Takeaway.com). Next to these, main additions to the portfolio in Q3 include the Carnival 2023 (US cruise line operator) and strengthening of our participations in the Schneider Electric 2026 (French electronic power products manufacturer) and Silicon Lab 2025 (US semiconductor). Main sales include the Atlassian (US software, called), Symrise 2024 (German chemicals) and Exact Sciences 2027 (US healthcare).

Outlook

- As we prepare for a more mature phase of the economic cycle, we expect heightened volatility and short-term drawdown risk. Proactive risk management becomes increasingly key to navigating the final stages of the recovery phase. The equity asymmetric nature of the convertible bond instrument makes them compelling assets for those who wish to maintain an equity exposure whilst dialling back their risk a bit.
- Convertible bonds' appeal is equally strong considering rising inflationary pressure for those who wish to maintain bond-floor defensive features. Thanks to their conversion option, convertible bonds have much lower interest rate sensitivity than straight bonds of similar duration. Though lagging equity markets year-to-date, convertible bonds are still outperforming all fixed income asset classes.
- Overall, we see the "economies reopening" momentum as an opportunity to tactically diversify our investments, rather than a questioning of our long-term focus on quality and growth companies. With the economic cycle set to mature, we believe that greater selectivity focusing on fundamentals will become critical again. This should benefit the convertible bond market through its large exposure to innovative companies in segments such as the tech, healthcare, or internet & distribution, that exhibit good earnings visibility, robust guidance and enjoy a privileged exposure to long transformation themes.
- Meanwhile, we expect the cyclical rotation still has legs and therefor remain agile in our security selection, to give room for "reopening-proxies" within our portfolios whilst always focusing on quality companies with healthy balance sheets.
- The record pace in new convertible bond issuance has sparked a deep broadening of the investment universe, resulting in a healthy mix of opportunities between innovative and well-established companies, as well as between "new economy" and typical "pro-cycle" names. Thanks to their dual nature, convertible bonds give investors the chance to be actively positioned on these themes with reduced volatility and downside risk than direct equity investments offer over time. **If anything, we believe the recent period of consolidation opens an attractive entry point into the hybrid asset class and sets the stage for longer-term performance.**

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