

# UBAM – GLOBAL CONVERTIBLE BOND

## Quarterly Comment

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### Market Comment

- While January benefited from a strong risk on momentum, the trend has started to reverse in February after higher than expected inflation numbers and central banks' officials' comments. In the beginning of March markets moved into a risk-off mode on the back of Silicon Valley Bank failure and the loss of confidence crisis impacting Credit Suisse. Interest rate volatility moved to a level lastly saw in 2008 before falling back. Central banks have continued to raise their respective policy rates despite these events in the banking sector. The Fed and the ECB rose their policy rates by 25bps and 50bps respectively. Their main focus is still inflation which hasn't fallen enough. They also reiterated that future decisions regarding their policy will be data driven, therefore economic data release will be key in the coming adjustments. Despite a tumultuous month of March, risky asset ended the quarter higher. However, with renewed recession risk, the long end of yield curves have fallen, the US 10-year rate fell by 41bps to 3.46% over the quarter. Despite the return of volatility during March, High Yield credit spreads tighten during Q1 down by 21bps.
- Despite the volatility over the month of March, major equity markets still delivered positive performances over the first quarter of the year and global equities ended the quarter up 7.7% (MSCI World TR). In the US, the S&P 500 index increased by 7.5% quarter-on-quarter; cross-Atlantic, the Stoxx Europe 600 index was up 10.5% q/q and the Nikkei 225 index also ended the quarter in positive territory, up 8.5% q/q (all performance expressed in local currencies). In terms of investment styles, there was an outperformance of the Growth segment over the Value (9.2% q/q for the S&P Growth index, 4.6% ahead of the S&P Value index). US Quality small cap lagged with the Russell 2000 Quality moving only 2.5% higher.
- Being up 3.9%, convertible bonds exhibited an encouraging behavior showing its capacity to both rally when market environment improves and to mitigate downside risk.
- Primary market confirmed the rebound seen the last quarter of 2022 as global markets introduced close to \$20 billion of convertible bonds during the first quarter of 2023. The US contributing \$12.9bn, Europe \$4.7bn and Asia \$1.8bn and Japan \$0.3bn.

### Performance Review

- Global convertible bonds (represented by the Refinitiv Global Convertible Bond index hedged in Euro, "the index") returned 3.9% q/q. With a net return of 1.3% in Q1, the performance of the UBAM – Global Convertible Bonds (IC EUR share class) was behind its universe. Most of the underperformance mainly comes from our absence in poor quality names (distressed CBs, unprofitable tech, crypto sensitive issuers, cruise liners, and Chinese ADRs) which led the January rebound. Region-wise, all regions contributed positively, but most of the performance has been driven by our investment in Europe. In terms of sectors, performance was driven by Technology, communication services and consumer discretionary while Utilities and healthcare detracted to the strategy's performance. At issuer level, top absolute contributors in Q1 include Sea Limited (Asia Technology), STMicroelectronics (Europe Technology), and Amadeus (Europe Consumer Discretionary). Main detractors were Akamai (US Technology), Jazz Pharmaceuticals (US Healthcare) and Halozyme (US Healthcare).

## Portfolio Activity

- At the end of March, the average equity sensitivity of UBAM – Global Convertible Bond stands at 38.0% (+4.9q/q), 1.0pts above its index. The strategy's interest rate sensitivity moved slightly lower, at 1.6 for a 3.0-year duration. The average credit spread of the portfolio remained relatively stable over the quarter and our credit profile remains very solid at 212bps and lower its index, 381bps.
- From a geographical standpoint, the fund is primarily exposed to equity markets through investments in the US (23.7%). Investments in Europe account for 10.1% and Asia and Japan for 1.8%. Relative to the index, the portfolio exhibits an average overweight stance to Europe (+3.7 pts equity sensitivity), while in line with the benchmark's US exposure and less exposed to Asian (-3.3pts) markets.
- Supported by a busy primary market we initiated several new positions that are in line with our Quality positioning. On the European market we participated in two new issues, Spie 2.0% 2028 and the Wendel exchangeable into Bureau Veritas 2.625% 2027. In the US, we participated in the Southern Cie 1.25% 2025, a utility company, and we made an arbitrage in our position in ON Semiconductor with a maturity of 2027 towards the new 2029 issue. In the semi-conductor space, we also sold STMicroelectronics 2025 to buy 2027 issue on the back of the upcoming call on the convertible bond with the shorter maturity. We initiated positions in Winnebago 1.5% 2025, one of the leading North American manufacturers of recreation vehicles. We also initiated a position in Palo Alto, another cybersecurity player that is experiencing remarkable growth. This came with the reduction of our exposures to healthcare names such as Jazz Pharmaceuticals, Conmed and Dexcom. We reduced our exposure to Booking given the high delta of the convertible bond and strengthen Accor to maintain an exposure to the travel industry. We also reduced our position in Akamai, whose strategic shift towards cloud computing is proving to be riskier than their historical data distribution and cybersecurity segments.

## Outlook

- The January outperformance from low-quality names was pricing excessive optimism and was not justified by the current economic environment. In the foreseeable future inflation should stay above central bank target and higher than experienced in the previous decade. Although economic data suggests that the overall slowdown could be smaller than previously anticipated, 2023 is still likely to be a challenging year for corporates. However, with global inflation pressure easing and rate hikes slowing, the factors holding back consumer demand and corporate earnings should fade throughout the year. That being said we still expect dispersion to be particularly high in the equity markets and we believe Quality is the right place to be invested thanks to intrinsic characteristics: Pricing power, healthy balance sheet, robust business models and clear visibility in earnings growth.
- Recent market events have been a good reminder that uncertainty is still very high, and that markets are fragile. In this context convertible bonds constitute an attractive way to maintain equity exposure whilst containing overall volatility. Especially after last year's reset, convertibles bonds with renewed profiles (convertible bonds moved towards "bond-like" providing better downside protection) have the potential to deliver strong risk-adjusted returns over the medium-term.
- Convertible bonds underlying equities are not expensive anymore and yield is back in the convertible bond universe. As a result, the outlook for convertible bonds is positive thanks to restored multiple performance drivers: underlying equity upside potential, yields and credit.

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