THE DRIVE YOU DEMAND

UBAM - MULTIFUNDS ALTERNATIVE

Quarterly Comment | Q2 2019

For Qualified Investors in Switzerland or Professional Investors or Eligible Counterparties as defined by the relevant laws.

Markets

- Global equity markets were up +3.23% during the second quarter of 2019 and stand at +15.90% YTD, as measured by the MSCI AC World Daily TR Net Index. After a very strong first quarter, Q2 was more volatile with two main elements influencing markets: trade war rhetoric, which initially escalated and then dampened further to the G20 meeting, and central banks, which have been intensifying their dovish stance, signalling possible rate cuts. In short, the market has been willing to ignore the weaker economic data in the hope that central bank stimulus will help avoid a recession.
- Developed Markets (DM) performed strongly in Q2, outperforming global markets on aggregate, with the notable exception of Japan. The S&P 500 TR ended the quarter up +4.30%, while the MSCI Europe gained +4.48%. In terms of styles, growth was once again the winner during Q2, while value and small cap underperformed global markets. Looking at sectors, Financials and IT were the strongest contributors. On the other hand, Energy was the laggard.
- Emerging Market (EM) equities were flattish during this second quarter of the year, with the MSCI EM TR Index being up +0.12%. As US interest rates decrease, a better environment for this asset class could emerge.
- Volatility increased slightly during Q2 but remained at a low level as of June-end (15.08) compared to the last nine months. It briefly topped the 20 mark during the month of May but came back down in June as markets rallied.
- After a very strong Q1, oil contracted somewhat between April and June (-2.78%). Q2 saw a revival in the price of Gold, as weak economic data increased fears of an economic downturn and demand for safe haven assets.
- Markets have been pricing in Fed rate cuts and the potential for further ECB quantitative easing (QE), all of which should be supportive of DM government bonds. However, and although global equities rebounded sharply in June and are off a very good start YTD, there are still a few headwinds that seem to be overlooked by markets so far, among which: (i) the on-going US-China geopolitical tension, (ii) slowing manufacturing data, (iii) early signs of a faltering American consumer, and (iv) a “whatever it takes” monetary policy easing that might not be sufficient to reverse the on-going global slowdown, all this leaving investors overly cautious at this juncture.
- In that context, we believe expanding asymmetric exposure through alternative solutions ahead of rising volatility prospects is a smart asset allocation move today. Indeed, an increased market uncertainty and volatility should provide a fertile ground for our UBAM - Multifunds Alternative fund. The Absolute Return characteristics of the portfolio, which combines mainly alpha drivers, traders and to a lesser extent, fundamental value managers, typically benefits from more risky environments. As traditional bond investors look for alternative strategies, we then believe that UBAM - Multifunds Alternative provides diversification through uncorrelated return drivers, limited beta and volatility, as well as controlled drawdowns.

Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Performance Review

- During the second quarter of the year, UBAM - Multifunds Alternative (Class IC USD) gained +0.81% (reported net of fees). The HFM UCITS FoF Index gained +0.11% for the period. UBAM - Multifunds Alternative has then outperformed its benchmark by a comfortable 70bps during Q2.
- Long/Short Equity, Macro/CTA and Relative Value contributed +112bps, +32bps, and +7bps respectively, while the Event Driven and Commodities allocations contributed negatively -5bps and -12bps to the portfolio (all expressed in gross terms).
- As most Long/Short Equity strategies contributed positively to the portfolio's quarterly gains, Fundamental Long-Biased and Moderate Net exposure strategies provided the largest weighted gains, adding to those already generated in the first quarter of the year. Our Long-biased manager was up over 7% in the quarter (and 16% YTD), while our Quantitative Long/Short Equity manager posted strong figures over the quarter as well.
- Two recent Long/Short Equity additions to the portfolio, both Fundamental Moderate Net exposure managers, contributed very nicely, adding incremental and diversified return drivers to the portfolio, while actually bringing risk moderately down. One is regionally focused in China and the other is a UK focused strategy investing predominantly in companies generating returns globally.
- All our Discretionary Macro managers provided positive returns in the space, while our Quantitative Macro strategy suffered small losses over the quarter following a difficult month of May being positioned long equities and short fixed income. Our Emerging Markets Fixed Income specialist was up +2.7% for the quarter. The Relative Value Asian focused manager, as well as the Global Fixed Income and Relative Value manager produced small gains too.
- Our Commodity expert had a difficult quarter losing 2.51%, as relative value trades in the energy space went against his positioning. Nevertheless, we recently increased exposure to this manager as we believe the opportunities in the energy space to be significant with the onset of IMO 2020.
- Finally, our Event Driven/Arbitrage and Healthcare & Biotech managers suffered moderate losses as the market downturn in May negatively impacted them; whilst the latter rebounded somewhat in June, the former had small losses.

Portfolio Activity

- UBAM - Multifunds Alternative is a weekly UCITS FoF investing in 10 to 20 uncorrelated, high conviction alternative managers from UBP's Approved List. It aims to be an Absolute Return portfolio acting as an alternative and/or complement to traditional fixed income investments.
- Its objective is to generate attractive risk-adjusted returns with low directional market exposure (low equity beta). The focus is on managers that have consistently generated alpha in different market environments. In order to deliver uncorrelated returns versus financial markets, the portfolio is constructed around three core return drivers: (1) Alpha Drivers with a moderate to neutral equity market exposure, such as Relative Value and Long/Short Equity Market Neutral strategies; (2) Trading managers with strong trading skills, such as Discretionary Global Macro, Commodity and Long/Short Equity with a trading bias; and (3) Fundamental Value managers seeking to exploit valuation opportunities.

- During the quarter, we fully redeemed from one of the Long/Short Equity Market Neutral managers, a strategy in which we had a relatively large exposure. Disappointing returns and our willingness to make space for more directional managers were the two main reasons behind this decision.
- In June, we added two Long/Short Equity Moderate Net managers, one China focused and one UK focused. Both have shown great skills and robust processes for capturing market upside as well as alpha, yet over time avoiding market weakness and capturing significant short alpha. While both managers are slightly more aggressive in their risk taking and volatility, the downside risk management and low correlations and betas underpin the valuable contribution we expect them to bring to the portfolio.
- During June we also added exposure to our Commodity manager, as we believe that the level of risk the team is running is significantly lower than when we initiated the position; despite the drawdown we also think there is an opportunity-rich environment in the energy space as a result of the globally important IMO 2020 regulation implementation, which reduces the amount of toxic sulphur content in bunker fuels from 3.5% to 0.5%. This has an impact across the energy value chain, as different crude supplies and qualities will be necessary to feed through refineries in order to have sufficient shipping fuel of the right quality (or ships to install scrubbers to comply).
- Strategy wise, the Long/Short Equity allocation was slightly increased from 45% to 47%; this has mostly been driven by slight adjustments to overall position sizing as a result of investment flows. The Macro book was slightly trimmed to 35% as a result of flows and trimming positions that we felt were increasing past target levels. Event Driven strategies were roughly stable at 8%, focusing on Merger & Mixed Arbitrage strategies. Commodity exposure was increased from 3 to 5%, as previously described.
- UBAM - Multifunds Alternative is a high conviction, hence relatively concentrated portfolio with 13 positions currently. The portfolio’s top 10 positions account for 87% of exposure; from a risk attribution perspective, these top 10 positions represent 92% of the portfolio’s overall risk profile.
- The portfolio’s equity beta remained fairly stable throughout the quarter at about 0.20.

Outlook & Positioning

- The Absolute Return profile of UBAM - Multifunds Alternative focuses on having a limited correlation to equity markets. We believe the portfolio is well positioned to benefit from a more uncertain environment with global growth slowing, Central Bankers becoming more and more sensitive and reactionary to small market shocks, and where policy outcomes may diverge from those of the recent past.
- The selection of Long/Short Equity managers in which we are invested have done very well this year so far, and we expect their performance to continue as the trends that we are seeing in 2019 reflect much of what we talked about and expected for this year. While fundamental long positions continue to perform well and in excess of the market, short positions are now generating absolute as well as relative outperformance, as investors are increasingly paying attention to capital structures, momentum and trajectory of growth, and in many cases valuations that leave little room for error.

- Generally speaking, we have seen more frequent episodic volatility across asset classes, and in this second quarter of the year, it was fixed income and FX volatility that increased, while equity volatility remained subdued – as opposed to Q4 2018 when equity moved more and the other two were quite flat.
- While Relative Value Macro remains attractive, we are seeing some attractive directional opportunities at the margin and are working on several interesting managers that we think could be strong candidates for the portfolio.
- Finally, Systematic Equity managers shall continue to offer alternative, liquid, risk-adjusted return streams via efficient, diversified, active, largely market neutral portfolios in a late cycle market environment, which is otherwise challenging for fundamental, concentrated, and directional managers.