UBAM – EUROPEAN 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

- The first quarter of 2022 was marked by central banks' fight against inflation and Russia's invasion of Ukraine. On the former, investors are being prepared for a period of monetary tightening, with the Fed gradually adopting a more hawkish tone. On the latter, the ongoing conflict affected financial markets and destabilised commodities market, causing the prices of oil, gas, metals and agricultural products to rise further.
- Eventually, global equities ended the quarter down 5.2% (MSCI World TR). In Europe, the Stoxx Europe 600 index dropped by 5.9% q/q. In terms of investing styles, the "Growth" play underperformed the "Value" overall, as revealed by the MSCI Europe Growth index down 10.5% q/q while the Value index is roughly flat.
- This has been a headwind to the European convertible bond asset class, traditionnaly biased towards Growth companies. Taking the Exane Europe Underlying index as a reference, the performance of convertible bonds' underlying equities is -13.8% q/q. This explains the lack of downside protection vs large equity indices during Q1 2022.
- In the first quarter, global markets introduced $8 billion of convertible bonds, with the US contributing $5.5n, Asia $1.2bn and Europe $1.2bn. This has been the weakest quarter in terms of volume for several years and leads to a net negative supply of 16bn$. Nothing to worry at this stage after a cumulative net supply of 50bn$ in 2020 & 2021. The recent rebound in market interest rates tends to support issuance historically as the relative interst of issuing convertible bonds vs straight bonds increases.

Performance Review

- In Q1, the UBAM – European Convertible Bond decreased by 7.31% after fees (IC EUR share class), outperforming its index, the Refinitiv Europe Hedged Convertible Bond index (EUR), by +2.05%.
- The equity sensitivity and fixed income bucket were the main contributor to the negative performance of the strategy over the quarter. Sector-wise, the only positive contributors were Energy (+42bps) and Utilities (+3bps). Consumer Discretionary (-141bps), IT (-117bps) and Health Care (-101bps) were the worst contributors. At issuer level, top contributors over the quarter include Total (+42bps), GTT (+31bps) and Glencore (+23bps). Conversely, our investments in Hellofresh (-58bps), Sika (-49bps) and Zalando (-47bps) hurt performance. Relative to the index, main contributors are Yandex (+120bps, index only), Delivery Hero (+79bps, underweight) and Ozon (+66bps, index only) while main detractors include our overweight exposures to Hellofresh (-47bps), Schneider Electric (-26bps) and Zalando (-22bps).

Portfolio Activity

- At March-end, the average equity sensitivity of UBAM – European Convertible Bond stands at 38.7% (-6pts q/q), +6pts above the index's. The strategy's interest rate sensitivity is very much contained at 2.1 for a 3.7-year duration. Lastly, the portfolio exhibits an average credit spread of 146bps (+39bps q/q) vs. 224bps for the index – levels that reflect the "quality" bias inherent to our security selection process.
- From a sector standpoint, the sub-fund is primarily exposed to equity markets through investments in Industrials (7.9%), Information Technology (7.6%) and Utilities (4.3%). With the Industrials, IT and Health Care also are the sectors that concentrate most of our current equity sensitivity overweight versus the index.

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.

- Within our portfolio, the large representation of both typically high growth sectors (tech, healthcare) and sectors gathering “recovery” businesses (e.g. leisure/travel and retail in consumer discretionary, aerospace in industrials) is a good illustration of both our historical focus on “quality-growth” companies, and the efforts we have made over the past year to diversify our portfolios through companies exposed to the reopening of economies.
- At single security level, main buys in Q1 include the investment in Total 2022 (switch back from our option position); the participation to the new BE Semi 2029 and our reinforcement in Hellofresh 2025. Main sales include the Orpea 2027 (exit following the controversy on the company); Edenred 2024 (reduced); Kering/Puma 2022 (switched to the Selena/Puma 2025).

Outlook

- The world economy is now expected to grow by 3.3% in 2022, as opposed to 4% expected at the end of last year. Output was fairly resilient at the start of the year but is likely to grow at below its potential rate in developed countries and China in the first half of the year. Geopolitical concerns, rising inflation and its impact on real incomes, worsening supply-chain problems caused by the war in Ukraine, and the closure of production centres in China represent significant headwinds.
- We think that the case of investing in Convertible Bonds is reinforced by this lack of visibility in a world of rising interes rates. Although the recent behavior hasn’t provided what one could expect, we think that this represents an opportunity rather than putting into question the long-term benefit of the asset class.
- Entering into 2022, we have been communicating on the opportunity offered by the underperformance of the underlyings of the asset class compared to equity markets. The first quarter of the year has reinforced this pattern and creates even more opportunities from our point of view. We think that in a world of decelerating economic growth (consequent to the fight against inflation, the war in Ukraine & the reopening tailwind fading), the Growth thematic will at some point be chased by investors. The asset class, being tilted towards this thematic, should benefit from this trend once it materializes.

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