

UBAM - EUROPE MARKET NEUTRAL

Quarterly Comment

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

Market Comment

- Despite starting the new decade in a good mood, the change in momentum of risk markets as 2020 progressed was inevitably noticeable. Investors were already on the lookout for an economic slowdown, but the cycle was interrupted more abruptly than anyone anticipated as the Covid-19 virus spread across regions. As of today, the disease has been declared a pandemic, causing large parts of the global economy to idle and making a global recession a reality.
- Following mixed performance in January where the initial virus impact was offset by the start of the year optimism, the quarter revealed itself to be very volatile, displaying negative returns across the board. The S&P500 index is down -19.6% for the quarter and set a number of records on its way down – fastest -30% decline, most violent peak to trough move and volatility comparable to 2008 despite markets only moving half as much... so far. The MSCI Europe ex-UK returned similar double-digit returns of -20.9%, followed by the MSCI EM at -23.6%. The UK FTSE All-shares was further behind with -25.1% during Q1. All indices are total return in local currency, except MSCI EM in US Dollars.
- A mixed picture on the credit side – higher prices for government bonds due to the announcements of lowered interest rates and the restart of quantitative easing programs but negative returns from the corporate bonds due to the threat of profits being under pressure as industries shutdown. The resulting performance is +8.2% for US Treasuries, +6.9% for UK Gilts and +0.3% for Euro Government bonds ranging from -1.5% for Spain to +1.6% for Germany. This contrasts sharply with corporate bonds which display -5.4% for Global Investment Grade and -14% for High Yield for both the Euro and US regions. All indices are total return in local currency, except global ones in US Dollars.
- Representative of the economic disruption, commodity prices were also hit as demand for most of them declined. Oil prices fell more than most, -60%, due to a combination of lower demand and interruption of the supply constraints between Russia and the OPECs. The one exception is gold which is up +5% this quarter as it tends to be an asset of preference when patterns fail and panic gains the markets. The extent of the hit to the economy is still unknown but a selection of indicators highlights the disruption: Chinese car sales fell by -80% in February, restaurant bookings are down -100% on some mobile apps and US unemployment claims doubled and were nearly 7 million. Most governments and central banks have taken supportive action by issuing government-backed loans or other fiscal stimulus, cutting rates and restarting asset purchase programs in an attempt to mitigate the economic consequences of the virus. This should allow to limit unemployment from growing further and prevent good business from going bankrupt.
- Overall, the first quarter of the year has seen sharp falls on both the equity and credit markets leading investors to navigate an extremely volatile environment with low liquidity. These factors limit the potential for efficient markets and will remain until short-term uncertainty decreases.
- In a context characterised by increasing market risks and volatility levels, as well as very low interest rates, particularly in Europe, many investors are considering alternative ways to diversify their portfolio exposure. UBAM - Europe Market Neutral provides access to an innovative solution that should provide diversification to traditional portfolios but also to other passive/smart beta type strategies.

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.

Performance Review

- In the first quarter of 2020, UBAM - Europe Market Neutral performed +3.52% (Class I EUR), during a period of extreme volatility for European equity markets and during which most other market neutral funds suffered. For example, the HFRX Equity Market Neutral Index (HFRXEMN) returned -7.80% in USD / -8.10% hedged in EUR over the same period whilst cash return proxied by the Eonia capitalisation Index (EONCAPL7) was slightly negative at -0.11% over the first quarter of 2020.
- In terms of contribution by expertise, our Long Only bucket contributed negatively -20.64% (gross of fees) to the overall portfolio, but generated a positive alpha of +239bps versus the beta-adjusted Eurostoxx 50 TR (SX5T) reference. The Short bucket contributed +24.56% (gross of fees), producing an alpha of 153bps.
- Within the Long book:
 - ▶ The alpha of the long book was a result of overweight positions in Information Technology, Materials and Utilities, as well as an underweight in Financials, Energy, and Consumer discretionary. In terms of countries, the portfolio was strongly overweight in France and the allocation there outperformed the index. Other countries with good relative performance included Spain and the Netherlands.
 - ▶ In terms of specific stocks positions, there were positive contributions from Cellnex Telecom and Ubisoft Entertainment (both Communication Services), Thales (Industrials), Eni (Energy) and AB Inbev (Consumer Staples). The top 5 contributors added +0.4% to the overall performance. On the negative side, Intesa SanPaolo, BNP Paribas & Allianz (all Financials), CNH Industrial (Industrials) and Umicore (Materials) were the largest detractors. The bottom 5 detractors removed -4.56% from the overall performance of the fund.
- Within the short book:
 - ▶ Short Bias, which represents 85% of the overlay allocation, as mentioned above, was a positive contributor, in line with the index.
 - ▶ Tail Risk, which represents the remaining 15% of the overlay allocation, was positive in terms of alpha generation. This was due to the significant move in volatility, with Vstoxx futures gaining +279% over the quarter, in particular during the month of March.

*Index provided for comparison and information purposes only. The fund has no official benchmark.

Portfolio Activity

- As a reminder, the long only bucket is determined by the systematic selection of amLeague®. The amLeague Euro 50A index, which is replicated in the long only bucket of UBAM-Europe Market Neutral, includes 50 stocks selected from 3 portfolio managers reporting on amLeague's platform. It is rebalanced on a quarterly basis.
- Overall our positioning during the first quarter was roughly in line with the market, with a beta of the long book ranging between 0.9 and 1, slightly higher than the positioning of the amLeague Euro50A index during Q4 2019.
- In terms of sectors, the largest allocations were in IT (21%), Materials (16%), both representing large overweights versus the EuroStoxx 50. Other large allocations included Financials (13.5%, slight underweight), Industrials (12.1%, in line with index) and Utilities (9.8%, overweight). On the other hand, Consumer Staples (7.8%), Consumer Discretionary (7.4%), Healthcare (5.4%) and Energy (1.7%) were all underweights. Communication services (5%) was in line with the index. Given the profile of the strategy, allocations remain stable over the course of the quarter.

Looking at single stocks, there was a significant active share of 58% versus the EuroStoxx 50. The top 5 positions were STMicroelectronics (Technology),

Iberdrola (Utilities), Sanofi-Aventis (Healthcare), Allianz (Financials) and Air Liquide (Materials), all but Sanofi-Aventis being overweights. The bottom 5 positions were ING (Financials), ADP (Industrial), Faurecia (Consumer), Ubisoft (Technology) and Kingspan (Industrial). Apart from ING, the other 4 positions are not included in the index.

- Within the Risk Management Overlay bucket, trend signals used in the Short Bias strategy began the quarter with a bullish positioning overall. Signals remained stable during January and February, and turned slowly bearish around the end of February, to finish Q1 2020 with a bearish positioning
- Within the Tail Risk bucket, the exposure to volatility futures was lean in January when signals remained at their floor. In Early February, both signals started to increase then came back to the floor a few days later. Finally, around February 18th both signals increased with the market turmoil to reach high levels of exposure at the end of the month and kept this level during the month of March.

Outlook

- The current pandemic dominates the narrative regarding the outlook at the moment. On one hand we have little visibility as to how and when economies normalise. The short-term impact is well understood but the longer-term impact is difficult to fathom. On the other hand, every crisis throws up opportunities. We remain vigilant regarding market risk, but we are very much keeping an eye out for these value opportunities, particularly where the market has treated high quality companies too harshly in our opinion.
- As a reminder, UBAM - Europe Market Neutral is beta neutral by design. However, the composition of the portfolio, particularly the long book, can change significantly each quarter. At the beginning of April, UBAM - Europe Market Neutral saw its long equity portfolio positioned with a defensive stance, with a beta on the long side of approximately 0.8. This is significantly lower than the previous quarter.
- The short bucket, which aims at hedging the beta adjusted long exposure, is positioned with a bearish stance, with an over protection on the short bias and tail risk allocations but is systematically rebalanced against the prevailing market and volatility regimes.

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