Q2 2020

UBAM – SRI EUROPEAN CONVERTIBLE BOND

Quarterly Comment

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

Market Comment

- The second quarter was marked by a sharp rebound in risky assets. The gradual lifting of lockdowns around the world, combined with governments and central banks' unprecedented support measures drove markets' recovery. Simmering geopolitical concerns and ever-increasing number of covid-19 victims globally caused some volatility but barely darkened the overall picture.
- Eventually, the MSCI World index jumped by 19.6% q/q, led by the US (S&P 500 up 20.5% q/q). In Europe, the Stoxx Europe 600 index rose by 13.5% q/q. In Japan, the Nikkei 225 index climbed 18.0% q/q. On the fixed income side, Euro IG corporates[1] added 5.1% q/q while their HY peers progressed by 11.2% q/q (indices performance expressed in local currencies).
- After hitting record highs at the peak of the crisis, equity markets' volatility returned to more contained levels in Q2, swinging in the 25-40pts ranges – yet still well above the VIX long-term average.
- In this overall context, convertible bonds stood out once again confirming what can be summarized as an historic H1 for the asset class. The holding of the bond-floor, alongside the noticeable share of growth-biased companies in the universe and convertible bonds' proven asymmetric behaviour, have been key drivers to the asset class' outperformance since the beginning of the year.
- At June-end, European convertible bonds[2] are down 3.7% YTD, which should yet be put in perspective with a negative performance of -12.1% for European equities[3] and of -5.0% for Euro HY corporates.
- In the first half, the global convertible bond market priced nearly USD 92 billion of new papers – the most in H1 on record. Region-wise, the vast majority came from the US market (USD 67bn). Europe and Asia priced around USD 12bn each. Looking into details, new issues can be split into two main categories. On the one hand, "rescue" deals from companies struggling amid pandemic-triggered lockdowns. On the other hand, and in sharp contrast, "opportunistic" deals from companies which have seen an acceleration of their activity during that period (especially companies in the tech and healthcare sectors).

Sources: UBP, Bloomberg Finance LP, BofA Merrill Lynch. [1]ICE BofA Euro Corporate index. [2]Thomson Reuters Europe Hedged Convertible Bond index (EUR). [3]Stoxx Europe 600 Net Return.

Performance Review

- UBAM - SRI European Convertible Bond progressed by 4.97% in Q2 (after fees, IC EUR share class), bringing its YTD performance to -1.73%. For purpose of comparison, the Thomson Reuters Europe Hedged Convertible Bond (the "index") rose by 6.84% over the past quarter. Year-to-date the index is down -3.70%, meaning an outperformance of close to 2% in favor of our strategy.
- Unsurprisingly, the equity sensitivity component was the main contributor to the strategy's absolute performance in Q2, backed by strong rebound in underlying stocks. Over the period, the strategy also benefited from its credit sensitivity and optional feature.
- The performance of the strategy in Q2 should be put in perspective with a rebound of +13.5% for European equities – meaning, an equity upside capture of about 37%, achieved with a balanced equity sensitivity of 25% on average during the quarter, and materially lower volatility (7% annualised for the strategy vs. 34% for the European equity index).
- Sector-wise, the portfolio's exposure to the Tech sector was the main driver to performance for the strategy in aggregate terms over the quarter. Top Tech contributors in Q2 particularly include STMicroelectronics (semiconductors) and Amadeus (Software). Communications and Industrial names were also strong positive contributors over the period, through holdings such as Delivery Hero (internet), Sika (building materials) or Deutsche Post (transportation).
- In comparison to the index, the extra-financial profile of the strategy was a solid source of added value over the quarter, accounting for +1.40% of the portfolio's relative performance in Q2. Looking into details, our "best-in-universe" ESG selection criteria proved particularly beneficial during the period. On the negative side though, the strategy was penalised by relatively slow implementation amid volatile market environment with high cost of liquidity (execution). On a YTD basis though, the strategy remains well ahead of its index with lower volatility.

Portfolio Activity

- With sharp rebound in equity markets, the average equity sensitivity of the portfolio increased during the quarter, from 18% end of March up to 30% at the end of June (vs. 32% for the index). On the credit side, the average OAS spread of the portfolio settles at 178bps at June-end, which compares to 310bps for the index.
- Major adjustments done in the portfolio during the quarter include:
  - Take-over situations management: in accordance with our process, neutralisation (at profit) of our aggregate exposure to Deutsche Wohnen (through the company's outstanding 2024 and 2026 convertible issues) following rumours of a takeover by a competitor.
  - SRI eligibility management: due to the deterioration in their extra-financial quality, we closed some of our investments over the period (e.g. Maison du Monde, Worldline, Technip, Telefonica). On the buy side, new additions during the quarter particularly include National Grid, SNAM, Kering/Puma, Amadeus, Cembra Money Bank and CA Immobilien.
  - Other noticeable moves include portfolio reallocations designed to raise the portfolio's expected Beta, in keeping with the strategy's guidelines.
- At quarter-end, the portfolio exhibits a fairly prudent profile as revealed by an expected Beta of 0.86 vs. the index, and a decorrelation with European equity indices (expected beta of 0.25 vs. the Euro Stoxx).
- At June-end, the strategy's extra-financial profile remains strong with an average SRI score of 5.99 /10 (vs. 5.19 /10 for the index).

Outlook

- In recent “V-U” shaped equity markets, convertible bonds have demonstrated strong asymmetric behaviour. The predominance of growth companies in the convertible space, combined with robust bond-floors and efficient adjustments in the asset class’ equity sensitivity proved key in that respect. Looking ahead, the case for convertible bonds remains strong.
- First, the convex nature of convertible bonds makes them compelling assets for those who wish to maintain an equity exposure whilst dialling back their risk a bit after Q2 overall sharp rebound. As risks continue to weigh on stock markets’ short-term prospects, an asymmetric equity exposure appears as a valid alternative to a full directional positioning. Convertible bonds’ appeal is equally strong in a low-to-zero yield world, for those willing to gradually return to equity markets to boost their fixed income investments whilst keeping the defensive benefits of the bond floor.
- Second, a focus on Growth makes sense, to favour companies with robust and visible prospects. The pandemic has put unprecedented strain on many industries, and adverse effects of the lockdowns remain to be seen. In sharp contrast, some segments of the economy – tech- and healthcare-related businesses on top – have witnessed a sharp acceleration in their activity, propelled by the faster-than-expected adoption of new consumer and business behaviours (work-from-home, e-business, factory automation etc.). In a climate of deep uncertainty, the visibility and strong growth prospects those companies offer are highly desirable assets. Their attractiveness is further strengthened in the ultra-low interest rate environment we are in (and which is here to stay, considering central banks’ actions), which is supportive of their valuation.
- The convertible bond market is rich in growth-biased companies, and primary activity has been booming in this segment. Through their “hybrid” nature, convertible bonds allow investors to enjoy an equity exposure to these superior-growth, but also traditionally highly volatile, names.
- On the primary activity side, issuance momentum is expected to remain strong as higher credit spreads tend to strengthen convertible bonds attractiveness for issuers with financing needs – as seen in Q2. Careful selection will remain paramount to focus on companies with robust credit quality, and sound prospects.

SRI Comment

STMicroelectronics | Semiconductors | UBI Scoring: 5.8*

- STMicroelectronics is the world's tenth-largest semiconductor vendor. STMicroelectronics is a prominent chip supplier into the industrial, automotive industries, and personal electronics. The Group's technologies are enablers of safer and greener mobility, advanced power & energy management across all types of systems and devices, and at the heart of the IoT & 5G. The group signed the United Nations Global Compact (UNGC) in 2000 and participates in the collective efforts of the industry to find solutions to face its biggest sustainability challenges, such as conflict minerals, working conditions, environmental protection and health & safety.
- Companies in the Semiconductors industry are exposed to environmental risk as they generate greenhouse gas (GHG) emissions, particularly those from perfluorinated compounds, from semiconductor manufacturing operations. STMicroelectronics deploys programs to reduce its direct and indirect greenhouse gas emissions from all its operations, including perfluorinated compounds (PFCs), which have a very long atmospheric lifetime and high global warming potential. 2019 was a landmark year for the group. It achieved its goal of reducing its GHG emissions by 21% compared to the 2016 baseline, six years ahead of its 2025 target. Currently 26% of its energy consumption is related to renewables use. The group is also committed to reduce its water footprint. Water is critical to the semiconductor production process, which requires significant volumes of “ultra-pure” water for cleaning purposes, to avoid trace molecules from affecting product quality. We see evidences of robust water management strategy compared to industry peers. STMicroelectronics adopted a comprehensive approach to water management, including water stress assessments, conservation programs, and initiatives with local communities to reduce water extraction and consumption. We see STMicroelectronics as better positioned to manage water costs, maintain access to markets, and minimize disruptions to operations associated with water shortages. Environmental data covers the 11 main manufacturing sites, representing more than 95% of the overall environmental impact of the group.
- In terms of social risk the group is exposed to data security issues. This is well embedded in STMicroelectronics’ strategy with the group offering solutions that cover the full range of security needs in electronics systems from software solutions embedded in general purpose microcontrollers, to dedicated embedded hardware and standalone devices that meet the highest security standards. Technologies are backed by a range of authentication solutions for brand protection and Trusted Platform Modules (TPM) designed to secure hardware. The group is also exposed to human capital development issues as it relies on highly-skilled workers. Given the fierce competition for hiring skilled individuals among companies in the semiconductor industry, STMicroelectronics' consistently high turnover rate poses concerns of potential brain drain, despite the company’s solid employee engagement efforts and competitive benefits and compensation. Aside from a high turnover rate, layoffs and restructuring events also highlight the company's exposure to labor and human capital risks.
- Looking at governance, STMicroelectronics‘ governance practices are well aligned with shareholder interest (majority of independent directors at the board with gender diversity; fully independent audit committee; above average accounting and financial reporting practices versus global peers). STMicroelectronics is a public company with ST Holding (French & Italian states holding company) holding 27.5% of the voting rights. Principle of one share one vote. We flagged potential government intervention concerns. The company has the ability to issue preference shares to prevent unsolicited takeover bids (poison pill) that are not supported by the Supervisory or Management Boards.

*Sources: UBP, MSCI ESG Research. *According to our internal SRI rating scale for this strategy, 10 is the best SRI grade and 1 the lowest.*

Disclaimer

This is a marketing document and is intended for informational and/or marketing purposes only. This document is confidential and intended only for the use of the person(s) to whom it was delivered. It may not be reproduced (in whole or in part) or delivered, given, sent or in any other way made accessible to any other person without the prior written approval of Union Bancaire Privée, UBP SA or any entity of the UBP Group ("UBP"). This document reflects the opinion of UBP as of the date of issue. This document is for distribution only to persons who are Qualified Investors in Switzerland, or Professional Clients, Eligible Counterparties or an equivalent category of investors as defined by the relevant laws (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. It is not intended for distribution, publication, or use, in whole or in part, in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it directed at any person at whom or entity at which it would be unlawful to direct such a document. In particular, this document may not be distributed in the United States of America and/or to US persons (including US citizens residing outside the United States of America). This document has not been produced by UBP's financial analysts and is not to be considered financial research. It is not subject to any guidelines on financial research and independence of financial analysis. Reasonable efforts have been made to ensure that the content of this document is based on information and data obtained from reliable sources. However, UBP has not verified the information from third sources in this document and does not guarantee its accuracy or completeness. UBP makes no representations, provides no warranty, and gives no undertaking, express or implied, regarding any of the information, projections or opinions contained herein, nor does it accept any liability whatsoever for any errors, omissions or misstatements. The information contained herein is subject to change without prior notice. UBP gives no undertaking to update this document or to correct any inaccuracies in it which may become apparent. This document may refer to the past performance of investment interests. Past performance is not a guide to current or future results. The value of investment interests can fall as well as rise. Any capital invested may be at risk and investors may not get back some or all of their original capital. Any performance data included in this document does not take into account fees, commissions, and expenses charged on issuance and redemption of securities, nor any taxes that may be levied. Changes in exchange rates may cause increases or decreases in investors' returns. All statements other than statements of historical fact in this document are "forward-looking statements". Forward-looking statements do not guarantee future performances. The financial projections included in this document do not represent forecasts or budgets, but are purely illustrative examples based on a series of current expectations and assumptions which may not eventuate. The actual performance, results, financial condition and prospects of an investment interest may differ materially from those expressed or implied by the forward-looking statements in this document as the projected or targeted returns are inherently subject to significant economic, market and other uncertainties that may adversely affect performance. UBP also disclaims any obligation to update forward-looking statements, as a result of new information, future events or otherwise. None of the contents of this document should be construed as advice or any form of recommendation to purchase or sell any securities or funds. This document does not replace a prospectus or any other legal documents, which can be obtained free of charge from the registered office of the fund they relate to, or from UBP. The opinions herein do not take into account individual investors' circumstances, objectives, or needs. Each investor must make his/her own independent decision regarding any securities or financial instruments mentioned herein and should independently determine the merits or suitability of any investment. In addition, the tax treatment of any investment in the fund(s) mentioned herein depends on each individual investor's circumstances and may be subject to change in the future. Investors are invited to carefully read the risk warnings and the regulations set out in the prospectus or other legal documents and to seek professional financial, legal and tax advice. This document should not be deemed an offer nor a solicitation to buy, subscribe to, or sell any currency, funds, products, or financial instruments, to make any investment, or to participate in any particular trading strategy in any jurisdiction where such an offer or solicitation would not be authorised, or to any person to whom it would be unlawful to make such an offer or solicitation. Telephone calls to the telephone number stated in this document may be recorded. UBP will assume that by calling this number you consent to such recording. UBP is authorised and regulated in Switzerland by the Swiss Financial Market Supervisory Authority and is authorised in the United Kingdom by the Prudential Regulation Authority. UBP is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority.
Any subscriptions not based on the funds' latest prospectuses, KIIDs, annual or semi-annual reports or other relevant legal document shall not be acceptable. The latest prospectus, articles of association, KIID and annual and semi-annual reports of the funds presented herein (the "Funds' Legal Documents") may be obtained free of charge from Union Bancaire Privée, UBP SA, 96-98 rue du Rhône, P.O. Box 1320, 1211 Geneva 1 ("UBP"). The Funds' Legal Documents may also be obtained free of charge from UBP Asset Management (Europe) S.A., 287–289 route d'Arlon, 1150 Luxembourg, Grand Duchy of Luxembourg, and from Union Bancaire Gestion Institutionnelle (France) SAS, 116 avenue des Champs-Elysées, 75008 Paris, France.
The Swiss representative and paying agent of the foreign funds mentioned herein is UBP. The Funds' Legal Documents may be obtained free of charge from UBP, as indicated above.