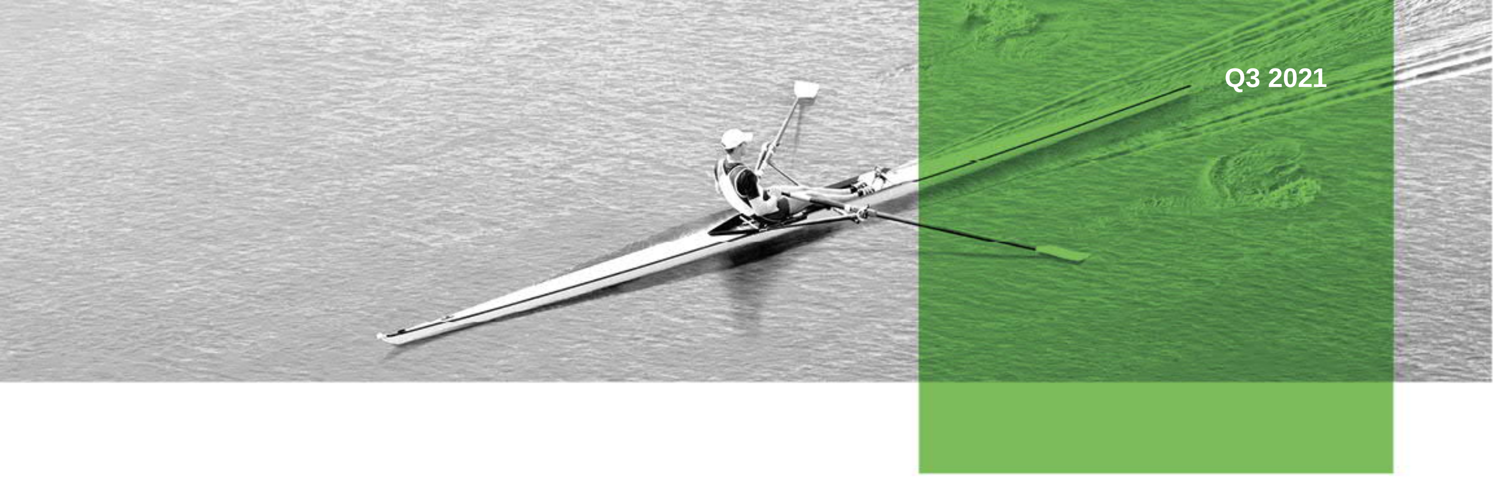

UBAM – Multifunds sustainable

Quarterly Comment | Q3 2021

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

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Market Comment

- It has been one of the fastest falls into a bear market on record with the S&P 500 Index for instance declining -30% from its most recent high in only 26 days! After the emergence of COVID-19 initially impacted sentiment across markets in Asia at the very start of the year, a ripple effect filtering west matured as whole economies were effectively shut down in order to contain the virus. These actions and the degree of uncertainty culminated in the worst calendar quarter for the MSCI World Equity Index (-21.0%) since the fourth quarter of 2008.
- Contagion was not only exclusive to equities, with surging risk premia's' also extending across the fixed income spectrum. Outright panic and the ensuing scramble for perceived safety and liquidity exacerbated the price moves, particularly within areas which are prone to increased price volatility when liquidity is limited. The cascading effects of this rippled to the very core of the world's monetary transmission mechanism which in turn prompted a co-ordinated monetary and fiscal response from the world's authorities. The scale of the response so far has been the largest in post-world war history which in turn provided risk assets to at least find a floor towards quarter end.
- Despite the US Federal Reserve cutting US interest rates to near zero in Q1, the perceived flight to safety and the ensuing strength in the US Dollar had a significant impact on asset classes in emerging markets with both equities and fixed income experiencing significant declines with the exception of China after signs that the worst of the crisis may now behind the country.
- From the intra quarter lows, markets have continued to grapple with and recalibrate an uncertain outlook for the global economy and what this means for equity and bond holders. With the world's economy now navigating through a recessionary period, investors have since the lows of the first quarter sought the relative safety in the more defensive sectors of the market versus their cyclical counterparts. The magnitude of the declines seen within some cyclical sectors have however pushed corresponding valuation metrics down to levels which have in the past corresponded with trough levels and particularly for emerging markets. The more defensive areas of the market meanwhile have remained valued broadly in line with historical averages. The market has also been quick to distinguish between companies with vulnerable balance sheet metrics versus those which haven't, with the rapid expansion in credit spreads leading to surging borrowing costs.
- Growth stocks were preferred over value stocks. On the factor side, large cap, as well as quality, including high ROE and low credit risk stocks, were preferred by investors. By sector, domestic demand-oriented and defensive sectors outperformed while the market fell. Overseas demand-oriented and cyclical sectors, such as mining, marine transportation, and metal & mining underperformed.

Sources: UBP, Bloomberg Finance LP.

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

- Overall performance from the fund was positive over the second quarter and the strategies continue to perform well over the years.
- Within the portfolio itself, most of the gains came from the bar-belled nature of the equity book, whilst the fixed income book was able to withstand a muted quarter for long duration fixed income overall.
- On the equity side, the more cyclically and operationally geared equity managers have experienced the strongest gains through 2021 as underlying portfolios have benefited by the strong rebound in global growth. Having begun the year at still relatively depressed valuation multiples, the majority are now back to mid cycle multiples and profitability measures.
- The best returns for these managers are arguably in the past for this cycle, however for now, they are still being buoyed by far stronger underlying earnings growth forecasts, particularly relative to their more defensive counterparts whilst the pent up operational gearing us further boosting profitability overall for this segment of the market.

Portfolio Activity

- During the quarter, portfolio activity was low as preference was maintained to capitalise from this ongoing rebound in global growth and still ample liquidity environment.
- Within the portfolio it is important to stress its emphasis in this regard. From an active versus passive discussion point, this deflation/recessionary trade has prompted an immense narrowing within market cap weighted indices as those benefiting from the work-from-home situation and the transition to a digital economy has propelled the five largest US Tech companies to become even bigger constituents within broad market indices. The top 5 stocks account for 24% of the S&P 500 Index for instance. In a sign that this trend may have reached an inflection point, breadth has changed markedly over the fourth quarter with equal weight outperforming cap weighted indices, the recovery is tentatively spanning out. The longer this continues, the easier it should be for active funds to outperform their passive counterparts.

- No major changes.

Sources: UBP, Bloomberg Finance LP.

Outlook

- There is a high chance the world could enter the greatest economic recession seen since the 2008 global financial crisis. The world will likely avoid a financial crisis this time around, given differences in the degree of over-investing and the stability of the financial system when compared to 2008. That said, large drops in private investing and consumption will be inevitable over the near term. Damage to the economy will be dependent on how long containment from the coronavirus takes, the impacts on economic activity and the resultant stimulus measures. That said, it is difficult to give any precise information. It is important to refrain from pessimism and bear in mind that if the coronavirus issue is a solvable problem, there will be investment opportunities over the medium term.
- Many countries across the world, whether developing nations or developed nations, are conducting lockdowns. If predictions that the contagion will approach its end during Apr-Jun turn out to be correct, there is a high chance the global economy will hit a bottom during this period, having undergone significant declines in GDP. Equities are highly likely already at a bottom and failed to drop further than the level seen in late-March.
- The impact on the real economy will soon be seen in macro indicators and corporate earnings. Bottom-up consensus earnings estimates have been significantly revised down already, but many more adjustments will be needed over the coming weeks. Arguably, the visibility on earnings will remain extremely low for a long period of time. Many companies have already withdrawn previously issued guidance. They will probably abstain from providing an outlook when they start reporting Q1 results in the middle of April but may just shed some light on the economic damage.
- Given the nature of this shock and the fact that there is no historical precedent, predicting the impact of the coronavirus on earnings is somewhat hazardous. This will depend on the actual depth and duration of the economic downturn; there is no doubt that the containment and social distancing measures implemented will have a huge impact on earnings. Declines in the magnitude of those seen during the Global Financial Crisis (GFC) cannot be ruled out, but the most affected industries (financials at that time) will not be the same.
- During the GFC, the 12-month forward PE of global equities slumped to about 8.5x (and to 10x in 2011). On March 23, the ratio fell to less than 12x, before rebounding to 13.5x. Note, however, that, compared to the situation going into the GFC, the sector composition has evolved with significantly lower weights of the commodity-linked and the financial sectors and a much higher weight for the technology and internet/media industries. Moreover, monetary and fiscal authorities have reacted in a far more aggressive and earlier manner than in 2008.

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