

# UBAM – EMERGING MARKET CORPORATE BOND SHORT DURATION

**Quarterly Comment** 

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

Market Comment

- The year started with optimism with the roll-out of vaccines around the globe, and the decision of the US new administration to provide a huge stimulus package of USD 1.9 trillion to support activity.
- Expectations of a sharp rebound in the US economy rapidly led to fears of an acceleration of inflation, however, which in turn, resulted in a steepening of the US rate curve. The 2-year US Treasury rates went up by 4 bps to 0.16% while 10-year rates increased by 83 bps to 1,74%.
- In parallel, commodity prices also shot up. The CRB index rose by 10.2%, thanks notably to the rally in oil (Brent +22.7%) and in basic metals (copper +13.4%). Precious metals, however, underperformed, with gold down 10.0% and silver down 7.5%.
- Volatility picked up over the quarter, but overall, EM corporate bonds remained well supported as investors remained comfortable with credit fundamentals, and large inflows into the asset class were strong (+USD 29.1 bn into EM hard currency bonds, of which +6.8 bn in pure corporate-focused funds vs. 5.3 bn in pure sovereign-focused funds) even if these flows slowed in March.
- This led EM corporate bond spreads to tighten over the quarter by 33 bps to 283 bps.
- Total return performance was negative (-0.99%), however, as a result of the rise in US rates. Still EM corporate bonds were less impacted than EM sovereign bonds (-4.54%), thanks to their much shorter duration (5 years vs 8 years).
- High Yield bonds outperformed, posting a marginally positive return (0.02%), thanks to their higher carry, lower duration and greater spread tightening over the period (-46 bps to 435 bps). Investment grade bonds returned -1.87% with a spread tightening of 32 bps to 177 bps.
- At a regional level, the best performance came from Africa (1.2%) and the Middle East America (-0.2%). In contrast, Latin America (-2.8%) and Europe (-1.1%) underperformed.
- At a country level, the best performance came from Ghana (+15.6%), followed by Azerbaijan (+4.2%) and Bahrain (+4.0%). In contrast, the worst performance came from Mexico (-4.3%), Argentina (4.0%) and Kazakhstan (-3.6%).
- At a sector level, the best performance came from commodities sectors: Infrastructure (-0.1%), Financials (-0.1%) and the Consumer sector (-0.7%). In contrast, Oil & Gas (-3.0%) and Pulp & Paper (2.4%) underperformed.
- The shorter end of the credit curve outperformed, thanks to its shorter duration: 1-3-year EM corporate bonds returned +0.9%, while 3-5-year bonds were broadly flat%.

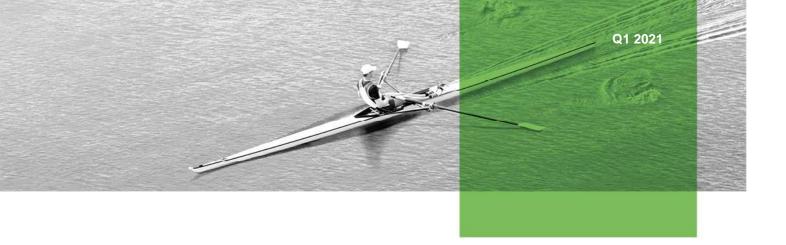


### Performance Review

- Over the quarter, the fund returned -0.26% net of fees. The fund benefited from its high carry and from spread tightening, but suffered from the rise in rates.
- At a country level, the best performance came from our holdings in Hong Kong, South Africa, Colombia and India.
- In contrast, our allocation to Chinese issuers, Ethiopia, Russia and Turkey proved costly.
- At a sector level, the best performance came from Industrials and the Consumer sector. In contrast, the fund suffered from its allocation to Financials, Sovereigns and Oil & Gas.

## Portfolio Activity

- Over the quarter, our scorecard remained in "dynamic" territory, as despite the rise in US rates, we remained comfortable on EM corporate fundamentals.
- We increased holdings in Latin America, Asia and Africa at the expense of Europe and the Middle East.
- In Latin America, we added exposure to Brazil (TMT, Oil & Gas), Colombia (TMT) and Chile (TMT, Consumer). In contrast, we reduced our holdings in Industrials in Mexico.
- In Asia, we increased holdings in China (Real Estate) and Indonesia (Oil & Gas) at the expense of India (Infrastructure, Metals & Mining).
- In Africa, we added a Supranational development bank as well as holdings in South Africa (TMT, Metals & Mining).
- In Europe, we sold our holdings in Kazakhstan (Financials) in favour of Ukraine (Metals & Mining).
- In the Middle East, we reduced exposure to the UAE (Financials).
- At a sector level, we favoured TMT, Oil & Gas and Real Estate at the expense of Industrials and Infrastructure.



#### Outlook

- Despite some delays in the roll-out of vaccines across the world, the global economy is expected to rebound sharply this year thanks notably to the large support packages that many countries have pledged. This rebound should be faster in Emerging Markets, led by Asia, than in Developed Markets.
- EM corporate fundamentals remain solid, with notably less leverage than in the US. This means that we can expect defaults rates to come down in 2021 and to remain lower in EM than those in the US.
- In parallel, and despite the rise in US rates, investors are expected to continue to look at EM debt as an asset class of choice providing attractive carry. This should lead to new inflows as experienced in the first guarter of 2021.
- We expect inflows into short-dated bonds to be sustained. Indeed, these appear attractive, with spreads of around 290 bps for 1-3- and 3-5-year paper vs only about 210 bps in 7-10-year bonds. Moreover, their low duration provides a cushion in case of further steepening of the US interest rate curve.
- In the current environment we prefer HY bonds as they offer greater carry and additional protection to absorb any rise in rates. The global recovery should also help to keep defaults rates low, further favouring HY. Still, we remain selective and rely on our internal, bottom-up, credit analysis to avoid issuers at risk.
- At a country level, our largest positions are in China, Brazil, Russia, South Africa and Colombia.
- At a sector level, our largest positions are in Sovereigns, Oil & Gas, Consumer companies and Industrials.

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