Q3 2020

UBAM – EM INVESTMENT GRADE CORPORATE BOND

Quarterly Comment

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

Market Comment

- The third quarter was split in two, with the continuation of the market optimism seen in Q2 in July and August and renewed concerns in September amid signs a resurgent virus could lead to more lockdowns and a deeper global recession.
- Over the quarter, US treasury bonds appear fairly stable, masking a rally in July, a sell-off in August when expectations that the worst had been avoided were predominant, and a new rally in September when the pandemic accelerated again. Overall, the curve steepened slightly, with 2-year US Treasury rates down -2 bps to 0.13% and 10-year rates up +3 bps to 0.68%.
- Commodities were also weak in September, on concerns of lower demand but overall stronger over the quarter. The CRB index was up by 7.6%, thanks notably to the rally in metal prices (silver +28%, iron ore +18%, copper +11%, gold +5.9%). Oil prices underperformed, however, up only 2.4%. The OPEC cut demand estimates for its oil by 1.1 million barrels a day, while surplus stockpiles of crude and refined products continue to build up.
- Contrary to many countries around the world, there are already signs that economic activity is picking up in China. Industrial production was up in August by 5.6% yoy. Manufacturing PMI came at 51.5 in September, while non-manufacturing PMI stood at 55.9.
- Overall, EM corporate Investment Grade bonds rose by 2.64% over the quarter, with spreads down by 33 bps to 289 bps.
- At a regional level, the best performance came from Latin America (+4.2%) and Africa (+3.5%). In contrast, Europe (+1.2%) and Asia (+1.9%) underperformed.
- At a country level, the best performance came from Egypt (+5.9% - Supranational), Chile (+5.4%) and Colombia (+4.9%). In contrast, Asian issuers from Thailand (0.0%), Taiwan (+1.1%) and Malaysia (+1.2%), as well as Russia (+1.2%) underperformed.
- At a sector level, the best performance came from Pulp & Paper (+7.1%), Infrastructure (+5.9%) and Diversified companies (+4.0%). In contrast, TMT (+2.1%), Industrials (+2.2%), Consumer (+2.3%) and Financials (+2.3%) underperformed.
- YTD, EM corporate Investment Grade spreads have widened by 69 bp but bonds posted a positive return of 4.61%, thanks to the rally in US treasury bonds.

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.

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Performance Review

- Over the quarter, the fund returned 2.57% net of fees. Gross of fees, the fund is up 2.78%, ahead of the JP Morgan CEMBI Diversified High Grade Index* (+2.64%).
- Performance attribution shows that the fund outperformed by 26 bps.
- The fund benefited from its credit selection (carry spread and spread effect +25 bps), while duration and curve positionning were marginally positive (+1 bp).
- Main contributors to relative performance, excluding the effect of our interest rate duration/curve positioning which is managed at portfolio level:
  - Country-wise, the best performance came from our underweight and selection in Singapore, Korea and Hong Kong. In contrast, our underweight in Colombia and Chile, selection in the Philippines, and overweight in India proved costly.
  - Sector-wise, the fund benefited from its selection in TMT, overweight in Industrials and underweight and selection in Utilities. In contrast the fund suffered from its selection in Consumer companies.
  - Our short protection (long market exposure) via CDX indices at the beginning of the quarter, when the market was rallying, also contributed positively.

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

Portfolio Activity

- Over the quarter, our scorecard remained in “balanced” territory, though the overall score trended down in September as fears of a second pandemic wave weighed on investors’ risk appetite. We increased holdings in Asian and European at the expense primarily of Latin America.
- In Asia, we favoured Indonesia (Financials, Utilities),) and the Philippines (Financials) at the expense of China (TMT)
- In Europe, we added to our holdings in Russia (Metals & Mining).
- In Latin America, we reduced our holdings in Chile (Utilities, Pulp & Paper) and Mexico (Metals & Mining) in favour of Colombia (Oil & Gas, Financials) and Panama (TMT).
- In the Middle East and Africa, we reduced holdings in Israel (Diversified), Qatar (Financials) and South Africa (Metals & Mining) in favour of Jordan and Saudi Arabia (Oil & Gas).
- At a sector level, we added holdings in Financials, Real Estate and Industrials. In contrast, we reduced our positions in TMT and Utilities.

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Outlook

- We expect the pick-up in volatility seen in September to remain in the short-term, given the increased risk of new lockdowns and the upcoming US elections. Still, we remain constructive on emerging debt for the medium-term.
- Indeed, the pandemic-triggered recession is likely to be less severe in emerging markets than it will be in Developed Markets (DM), and the rebound next year is expected stronger. In its World Economic Outlook, published early October, IMF forecasts emerging economies to slow by 3.3% this year and bounce back by 6.0% in 2021, vs -5.8% and +3.9% respectively for DM.
- Also, investors' appetite for yield remains high and valuations of EM bonds appear attractive especially compared to US and Euro credit, where the combined actions of G3 central banks have pushed Developed Market yields to extremely low levels.
- Importantly, if considering corporate issuers, fundamentals appear more solid than in DM, as leverage for both IG and HY issuers remains lower in EM than in DM. As it is, year-to-date, the default ratio in EM corporate remains lower than in US High Yield credits.
- Still, we recognize that the economic slowdown will have a negative impact on issuers' creditworthiness. Hence, thorough issuer selection remains of paramount importance. We thus rely on our sovereign and credit analysts to avoid negative credit events, with special focus on:
    - Issuers' capacity to generate operating cashflows and maintain a good level of activity, and keep adequate liquidity
    - Their capacity to refinance
    - Their ability to support the leverage accumulated during the crisis
    - Valuations to identify attractive opportunities (overly penalised issuers)
- At a regional level, we are overweight in Asia and Europe and underweight in Latin America and Middle East & Africa.
- At a country level, our largest overweight positions are in India, Russia, South Africa, Russia and Indonesia.
- Our largest underweights are in Qatar, Chile, Singapore, Saudi Arabia and Korea.
- At a sector level, our largest overweight positions are in Metals & Mining, Industrials and Infrastructure. Our largest underweights are in Financials, Oil & Gas, and the Consumer sector.

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