U ACCESS – CHINA CONVERTIBLE BOND

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws. The classification of the fund(s) as per the Sustainable Finance Disclosure Regulation (SFDR) is available on ubp.com or in the latest prospectus.

Market Comment

- Chinese economy has been showing signs of stabilisation over the third quarter of the year. Most of the upside was led by consumption and manufacturing activity, with SOEs outperforming the private sector. Retail sales recovered substantially to 4.6% y/y in August, up from 2.5% y/y in July. The recovery was driven by cyclical factors. Industrial production exceeded expectations, reaching 4.5% YoY in August, up from 3.7% in July. Notably, State-Owned-Enterprises, 5.2% YoY, continued to perform better than private enterprises, 3.4% YoY. Over the quarter the Chinese government announced support, with rate cuts and a broad package of fiscal support measures to boost consumption (targeting Autos, EVs and home appliances sectors) and housing demand. This macroeconomic environment weighed on Chinese financial markets.
- For the quarter ending 25th September 2023, China's domestic stock market (hereafter the "A-share market") fell by 1.8% (CSI 800 Total Return Index). For purpose of comparison, over the same period, Hong-Kong-listed mainland securities (the Hang Seng Index, HSML100) was down -2.5% (CNH, total return).
- Over the past three months, the top 3 performing sectors of the A-share market were Non-banking Financials (+6.2%), Steel (+4.9%), and Textile & Apparel (+3.6%). At the bottom-end, Electrical Equipment (-14.1%), Computer (-19.1%) and Media (-20.6%) reported the most negative returns q/q (based on ShenYin WanGuo classification).
- During the third quarter, convertible bond issuance in domestic China totalled CNY 42 billion through 45 new convertible issues. At June-end, they are 542 convertible bonds in the Chinese onshore market, for a total outstanding amount of CNY 1,058 billion.

Performance Review

- In Q3, the strategy decreased by 0.9% (U Access – China Convertible Bond IC CNH), below the on-shore convertible bond market (CSI Convertible Bond Index) by 0.6%*. This brings the performance since 27th december 2022 to 2.2% by the 25th September 2023. Sector-wise, most of the underperformance is coming from our underweights in Financials and from our bond selection within the industrial sector during Q2. On the opposite-end, underweight to Information Technology had a positive relative impact on the quarter performance. Overall, our bond selection contributed 90bps to our relatively performance while sector allocation detracted 147bps.
- The Chinese equity market fell over the quarter on the back of continuous economic difficulties, being down 1.8%. Over the same period, the on-shore convertible bond market (CSI Convertible Bond Index) fell only 0.3%.

Portfolio Activity

- The investment level of the U Access – China Convertible Bond portfolio remained above 95% for the whole period under review. In comparison to the investment universe, we maintained an underweight exposure to the Financial sector in accordance with our systematic approach which aims to ensure sufficient portfolio diversification. For purpose of indication, the portfolio's exposure level to the Financials sector was on average 16%, compared to an average weight of 31% for the universe. Likewise, the cumulative weight of the portfolio's top 10 holdings remained circa 11% (vs. 29% for the investment universe).

Quarterly performance calculated between the 26th June 2023 and the 25th September 2023. Index is for reference purposes only and no comparability or relevance is warranted or implied. For indicative purpose only, the strategy has no official benchmark.

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.

- In terms of risk profile, throughout the quarter, the portfolio maintained greater allocation to both the “balanced” and “higher equity sensitivity” segments than the investment universe, and an underweight positioning to the “bond-like” segment.
- At September-end, the portfolio exhibits an average equity sensitivity of 63.5%.

Outlook

- Activity indicators point to stabilization in August, and we maintain our GDP forecast for 2023 unchanged at 4.8% (consensus: 5.0%). We have kept our forecast for 2024 unchanged at 4.5%. After staging a brief recovery in Q1-23, the real estate sector has once again returned to a contractionary state. Recent measures to boost property investment have not yet been reflected in the data, as this doesn’t happen retroactively. This process will require time, so investors might have to be patient. We expect that macroprudential easing will support real estate demand in the quarters ahead, particularly in tier-1 cities. Growth will remain uneven in Q3-23, before converging towards trend in Q4-23. The government has delivered a myriad of targeted support measures, but we do not expect a 2008 style bazooka this time around. Therefore, it will take longer to engineer the desired inflexion in real activity.
- A-share equities are still trading at a 5Yr Cyclically Adjusted Price-to-Earnings ratio attractive level of 12.5x (vs. 15.4x historical average). To our view this could represent an attractive entry point for long term investors. However, the high volatility associated with A-shares has historically been a drawback when considering exposure to onshore China. Thanks to their dual nature, convertible bonds give investors access to A-shares with lower volatility and reduced drawdown risk.
- The Chinese onshore convertible bond market offers access to companies and sectors with a direct or indirect exposure to the growing Chinese consumer’s demand. In our view, these constitute a fertile hunting ground as China moves to its era of “common prosperity”.
- Our U Access – China Convertible Bond strategy follows a systematic selection & allocation approach. The latter has been designed to provide investors with a liquidity-enhanced and diversified exposure to China’s on-shore convertible bond market, which is capable of navigating the A-share market’s bouts of volatility, as evidenced by the outperformance achieved by the strategy since its inception compared with both the equity market and the convertible bond universe.

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