

U ACCESS (IRL) TREND MACRO

Quarterly Comment

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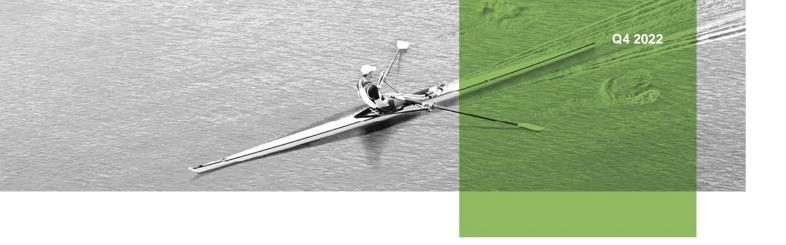
Market Comment

- The fourth quarter of 2022 saw a relief rally in risk assets across the board, capping a very difficult year for equity and bond markets. This rebound did come with some volatility however as markets corrected in December after a strong positive move in October and November. Expectations of a more dovish fed, with even some participants anticipating rate cuts as soon as 2023 were the main catalysts. In terms of regions, Europe and Emerging markets outperformed the US, with the UK even ending the year in positive territory, driven by the weakness of the British Pound. China ended a very volatile year with a strong rally as the government's looked to move beyond its zero Covid policy. In Fixed Income, EM debt and Investment grade outperformed High Yield. Government bonds were positive overall but Europe and Japan saw negative returns.
- Despite some relief in Q4, 2022 will be remembered as the year when both equity and fixed income markets were repriced due to higher inflation and interest rates. A recession is now widely expected in 2023 and markets are anticipating a decline in inflation and possibly in interest rates, which could be supportive. Commodity prices stabilised on aggregate in Q4, which helped taming inflationary pressures. Markets could remain macro driven in the near future, focusing on the Fed and economic data, but once the extent of the potential recession becomes clearer, fundamentals could reclaim centre stage and dispersion could return.
- The current market environment provides a very interesting set of opportunities for our U Access (IRL) Trend Macro fund, which offers access to diversifying risk drivers and exposures by seizing long and short investment opportunities across mainly interest rates, credit and currencies, both in Developed and Emerging Markets. It has historically shown a low correlation to traditional assets.

Sources: UBP, Bloomberg Finance LP, BofA Merrill Lynch

Performance Review

- For the fourth quarter of 2022, U Access (IRL) Trend Macro returned +1.30%, bringing YTD performance to +5.59% (Class B USD, net of fees). Overall PnL for the quarter was +6.1%. In terms of contribution by asset class: Credit led positive contributions (+5.7%), followed by Rates (+0.6%), while FX (-0.5%) and Equity Indices (-0.1%) detracted performance for the quarter. Corporate Credit was the largest contributor (+2.6%) and the short CDX HY position was the largest detractor (-2.8%).
- Other positive performance in the quarter came from China Quasi Sovereign (+178bps), Angola Credit (+140bps) and Egypt Credit (+119bps).
 Other negative performance from the quarter came from CDX EM (-34bps), Ghana Credit (-30bps), and AUDUSD (-24bps).



Portfolio Activity

- Fixed Income: Coming into the fourth quarter, we had established a sizeable position in EM HY Sovereigns and we used the rally in October to year-end to book profits on most of our positions. We exited Angola, Argentina Provinces, Egypt and Mexico and greatly reduced our position in Kenya. The China High-Yield/distressed portfolio rallied sharply in Q4 from its November lows, driving our positive performance for the quarter as policy towards the real-estate sector did an abrupt U-turn. We continue to hold this portfolio since it still trades at what we believe are very undervalued levels.
- FX: We saw opportunities being short euro vs EM FX with a focus on countries that tightened significantly during the past year and remained hawkish (Brazil, Hungary, Mexico). We have since exited those positions on the back of political risks
- Hedges: In anticipation of a slowdown in the US economy, we established shorts in CDX HY while using call options for protection.

Outlook

- Markets are priced for a soft-landing. The rally in Q4 has continued into the New Year. Markets expect very mild slowdown and hence earnings to be up 4% this year at \$229. They also expect that the Fed will finish hiking by March and are currently pricing in 50-60bp of rate cuts in H2-2023. Finally, markets expect inflation as measured by 1yr Breakeven swaps to miraculously decline to 2% by end-2023. The rally has eased Financial Conditions back to levels that prevailed in June-2023 markets have unwound a great deal of the tightening that the Fed has engineered.
- What is wrong with this story? Wages. Wages tend to be downwardly inflexible. And wage growth measured properly (not Average Hourly Earnings) by the Employment Cost Index (ECI) and the Atlanta Fed Wage Tracker show wages moderating but still rising at rates well-above what is needed for the Fed to achieve the Fed's 2% inflation target. As we detailed last month, it is wages that drive core Services CPI ex-shelter. Historically, whenever labor markets are this tight, the only way to bring wages down is thru higher unemployment. i.e. a recession. The story propagated by some analysts that job openings can miraculously decline without a large decline in jobs is simply fantasy as we have written about previously in our discussions about the Beveridge Curve.
- So, what does the team expect? For now, the rally continues until everyone is dragged in kicking and screaming. And then the bottom falls out as markets realize that inflation is stickier than expected and the Fed is NOT going to cut rates in 2023. It never ceases to amaze us that when markets want a bullish narrative, they always find a way to criticize the Fed if the Fed stands in the way of the story. The FOMC was starkly clear in its December Minutes when it told markets that none of the FOMC participants anticipated cutting rates in 2023. But markets don't care. For now. So, by all means enjoy this rally. But please be a renter and not an owner.

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