THE DRIVE YOU DEMAND

UBAM – EM INVESTMENT GRADE CORPORATE BOND

Quarterly Comment | Q2 2019

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

Market Comment

- The quarter was marked by heightened trade tensions between the US and China, further signs of economic slowdown especially in developed markets, and central banks, like the Federal Reserve or the ECB, adopting a more dovish stance.
- As a result, US Treasury bonds rallied over the period (2 year rates -51 bps to 1.75%; 10-year rates -40 bps to 2.01%).
- In contrast, commodity prices were weak. The CRB index lost -1.5%, with oil down -2.7%, and copper prices down about -8%. Precious metals outperformed (gold +9.1%, silver +1.3%).
- The G20 meeting between President Trump and Xi delivered as we had expected a cordial exchange between the two leaders, the restart of trade negotiations and some grace allowing US companies to temporarily sell some goods and services to Huawei. This plus the Fed continuing to signal interest rate cuts and the ECB indicating willingness to ease monetary policy explain the market rebound in June.
- Inflows into EM bonds have reached USD 45.1 bn in the year to date, of which USD 37.9 bn into EM hard currency debt.
- Overall, EM investment grade corporate bonds returned +3.61%, thanks to lower US rates and a spread tightening of -3 bps to 207 bps.
- At a regional level, Latin America (+4.3%) and Europe (+4.1%) outperformed, while the Middle East (3.3%) and Asia (3.4%) underperformed.
- At a country level, the best performance came from Macau (+5.1%, Sands China - Consumer). Chile (+4.7%, Celulosa Arauco – Pulp & Paper) and Morocco (+4.6%, OCP - Industrial) also performed strongly.
- Lowest performers included low-beta, low-yielding issuers from Poland (2.8%, PKO - Financials), Qatar (2.8% - Ahli Bank), or Hong Kong (2.8%, Bank of East Asia).
- At a sector level, the best performance came from Pulp & Paper (4.9%, Celulosa Arauco – Brasil), and Metals & Mining (4.6%, Southern Copper - Mexico). In contrast, Financials (3.0% - Haitong Securities, China) and Diversified companies (3.5%, Hutchison - Hong Kong) underperformed.

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

- Over the quarter, the fund returned 3.71% net of fees.
- Gross of fees, the fund outperformed its benchmark by 27 bps.
- Over the period, both our credit selection and our duration and curve positioning contributed positively.
- In terms of credit selection (carry spread effect plus spread duration effect):
    - At a country level, the best performance came from our selection in Mexico and Hong Kong. Our underweight in Korea and Singapore also contributed positively.
    - In contrast, the worst contributor to performance was our selection in South Africa.
    - At a sector level, the main sources of outperformance were our underweight in Financials and TMT.
    - In contrast, our underweight in the Consumer sector, weighed on relative performance, as did our selection in Industrial companies.
- YTD, the fund has returned 8.55% net of fees, and 8.99% gross of fees, vs. 8.73% for the index.

Portfolio Activity

- Over the quarter, as trade tensions increased, we reduced our spread duration to a more neutral position.
- At a regional level, we added to our holdings in Latin America and Europe at the expense of Asia.
- In Latin America, we increased our exposure to Brazil (Industrial, Pulp & Paper) and Colombia (Financials).
- In Europe, we increased our overweight position in Russia (Oil & Gas).
- In Asia, we reduced our exposure to expensive credits in Korea (Financials, Metals & Mining), Hong Kong (Diversified, Real Estate) and China (Financials, TMT). In contrast, we increased our holdings in Malaysia (Utilities).
- In the Middle East, we reduced our holdings in Kuwait (Financials, Industirals) and Qatar (TMT, Financials), but added exposure to Saudi Arabia - though maintaining our overall underweight - (Industrials).
- At a sector level, we increased exposure to Industrials, Pulp & Paper and Oil & Gas at the expense of Metals & Mining, Infrastructure and TMT.

Outlook

- After a strong first half of the year, we expect the summer to be more range-trading. The global and EM economic climate has improved. And the Fed seems willing to act pre-emptively, cutting before a recession has hit the US and addressing any fears that it might be behind the curve.
- That said, a lot of good news has now been digested by the market. Moreover the ECB meeting on July 25 and the Fed meeting on July 31 are unlikely to deliver more than already priced in. Rate futures markets are pricing in some chance of an ECB 10bps cut and a 75% change of a 25bps cut from the Fed (25% chance of a 50bps cut).
- We thus think the environment will remain generally supportive for EM but given the fast recent gains, a period of consolidation seems appropriate first, before further drop in yields.

- In particular, Emerging Market bonds should attract investors due to the low yield environment, a light political agenda, an increasing gap between EM and DM growth, and sound EM corporate fundamentals
- We have thus positionned our portfolio accordingly, with a neutral spread duration, but maintaining our overweight in higher carry bonds.
- At a country level, our largest overweights are in Brazil, Singapore, South Africa and Russia.
- Our largest underweights are in Korea, Saudi Arabia, Qatar and Hong Kong.
- At a sector level, we favour Metals and Mining and Industrials at the expense of TMT and Financials.