UBAM – EMERGING MARKET DEBT OPPORTUNITIES

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

- 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%.
- The first three months of 2021 saw inflows into EM debt, reaching USD 29.1 bn of which USD 11.7 bn were in hard currency (primarily in EM corporate bonds) and USD 17.4 bn into EM local currency bonds.
- Volatility picked up over the quarter. Sovereign bonds suffered from their long duration (7.9 years) while local markets were hit by the stronger dollar (+3.7% against a basket of the major world currencies).
- EM corporate bonds, in contrast, benefited from their shorter interest rate duration (5.0 years) and outperformed (-0-99%), with spread tightening by 33 bps to 283 bps. The best performance came from Infrastructure (-0.1%), Financials (-0.1%) and the Consumer sector (-0.7%). In contrast, Oil & Gas (-3.0%) and Pulp & Paper (2.4%) underperformed.
- EM sovereign bonds returned -4.54%, with spreads broadly stable over the quarter (+3 bps to 354 bps). At a country level, the best-performance came from Venezuela (+16.5%), Sri Lanka (+10.1%), Zambia (+9.8%) and Costa Rica (+6.9%). In contrast, Argentina was the worst performing country (-15.1%), followed by Belize (-14.0%), Ecuador (-13.1%) and Panama (-8.8%).
- EM local bonds underperformed (-6.68% in USD terms) due in part to the USD weakness as well as to a rise in local rates in many countries. In local terms, EM domestic bonds were down 3.19% over the period.

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

- The fund returned -2.06% net of fees over the quarter. As an indication, the performance of the JP Morgan EMBI Global Diversified* ex CCC is estimated at -4.47%.
- The fund benefited primarily from our active duration management. Our credit selection also contributed positively. In contrast, our exposure to local currency proved costly.
- Over the period, our overweight in corporate bonds at the expense of sovereign was beneficial to performance and helped limit the drawdown.
- In hard currency, at a country level, the best performance came from our zero exposure to Turkey and Ecuador, underweight and selection in Argentina, selection in Peru and Colombia.
- In contrast, the worst performance came from our selection in China, underweight in Oman, zero exposure to Sri Lanka and El Salvador.

Portfolio Activity

- Over the quarter, our scorecard remained in “dynamic” territory, as despite the rise in US rates, we remained comfortable on EM fundamentals and on the relative attractiveness of EM bonds compared to other fixed income asset classes, which should support further inflows.
- Over the period, the fund’s AUM almost doubled from USD 44 million to USD 81 million. Inflows were invested primarily in corporate bonds at the expense of sovereigns.
- Region-wise, we favoured Asia at the expense of Latin America and Europe.
- In Asia, we increased holdings in India (Infrastructure), Thailand (Industrials) and China (TMT, Real Estate), at the expense of Malaysia local bonds.
- In Latin America, we cut down holdings in Chile (Consumer, Pulp & Paper, TMT), Dominican Republic (sovereign) but increased exposure to Brazil (Oil & Gas, Consumer, TMT).
- In Europe, we reduced exposure to Russia (we cut down holdings in sovereign and local currency bonds but added in corporate issuers) and Romania (sovereign).
- In Africa, we added to our positions in Egypt sovereign. The country has fairly weak fundamentals but proved to be resilient last year, with real GDP growth estimated at +1% (one of the few countries with positive GDP growth) and a primary fiscal surplus. After a relatively large issuance earlier this year, Egyptian bonds cheapened on the back of unfavourable market technicals. We took this opportunity to build a position in longer-dated bonds in March. In contrast, we reduced exposure to Senegal (sovereign).
- We lowered our exposure to local currencies from 15% to 10%. We closed our longs in BRL, CNY, MXN and reduced our longs in MYR, PLN, RUB, UYU. Still, we opened new longs in INR and KZT, and added to our exposure in IDR.

- Over the quarter, we traded actively our duration positioning. We first fully hedged our interest rate exposure at the long end (10+ years), reducing duration from 5.8 at the end of December 2020. to 4.1 in the first days of February. Given the extent of the sell-off in long-dated US Treasury bonds, we then took profit, on expectations that US rates would start to stabilise. We lifted our hedges at the end of February. Our interest rate duration stood at 6.5 at the end of the quarter.

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 quarter of 2021.
- In that context, EM corporate bonds, with their lower volatility and higher Sharpe ratios than EM sovereign debt or EM local debt, appear even more appealing. Their lower duration (5.0 years) compared to that of EM sovereign bonds (7.9 years) is also positive as pressure on the longer end of the US curve remains.

- Overall, we continue to favour corporate bonds over sovereign ones, and have selective exposure to local currencies.
- At a regional level, we favour Latin America, Asia and Africa.
- Our largest country exposures are in China (corporate), Brazil (corporate), Colombia (corporate/sovereign), South Africa (corporate) and Indonesia (Quasi sovereign, sovereign, local bonds).
- At a sector level, our main corporate exposure is in TMT, Industrials, Oil & Gas and Consumer companies.
- In FX, we have a small net long exposure, mainly in INR, PLN, IDR and UYU.

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