



UBAM – EM RESPONSIBLE CORPORATE 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

- Despite pressure early in the quarter, when rising bond yields and conflict in the Middle East weighed on emerging market (EM) returns, overall EM debt was strong in Q4 2023. Signs of a “soft landing” for the US economy and increased expectations for interest rate cuts in 2024 were supportive. However, China continued to be a drag on broad EM performance.
- In the US, lower energy prices and the strong jobs market gave households renewed confidence and underpinned consumer spending. However, sentiment in the manufacturing sector remained weak, with regional survey readings lower than expected and a manufacturing PMI of less than 50 (as opposed to 51.3 in the service sector). Headline inflation fell to 3.1% in November while core inflation remained at 4.0%. As expected, the Fed did not adjust its key interest rates in its final meeting of the year, but the FOMC is expecting to make three rate cuts in 2024 and Jerome Powell acknowledged that the governors have discussed when those cuts could begin, and this news was very well received by the markets triggering a continuation of US rates’ rally in December.
- In the eurozone, economic indicators remained depressed overall. Eurozone retail sales stabilised, but confidence indicators for the manufacturing and service sectors suggested that output was continuing to fall, and at an even faster rate in manufacturing. Weak demand and sharply falling energy prices meant that eurozone inflation continued to drop to 2.4% year-on-year in November, from 2.9% in October. The ECB kept its official rates at their record highs and stated that the Governing Council had not discussed rate cuts because inflation is still too high.
- In China, economic indicators were mixed, although there was a slight acceleration in retail sales and industrial output. Credit spreads on corporate and emerging-market bonds tightened almost across the board in December, which meant that returns for 2023 as a whole were very solid. Equity markets gained over 4% on average in December, with the US market slightly outperforming and Japan underperforming. Overall, equities returned over 20% in 2023. The increasing probability that official US interest rates will be cut several times in the relatively near future was bad news for the dollar.
- The economic and geopolitical environment was helpful for gold, the price of which rose 1.3% in December after hitting a new all-time high of over USD 2,100 per ounce during the month. As regards oil, investor doubts about whether voluntary production cuts by OPEC+ members would materialise dragged down oil prices, with Brent crude falling by 7%.
- EM investment grade corporate bonds index was up by 3.1% (JPM CEMBI BD IG), led mainly by the rally in US base rates but also by the tightening in spreads (spreads tightened by 11bp to 154bp). By region, Asia IG spreads tightened by 6bp, Latam IG by 22bp, EM Europe by 33bp and Middle East by 11bp.
- At a country level, the best performing countries over the month were Kazakhstan (+10.8%), Thailand (6.5%) and Mexico (+6.1%). The worst performing countries were Philippines (0.7%), Qatar (1.7bps) and China (1.7%). At a sector level the best performing sectors over the month were Oil & Gas (+6.8%), followed Pulp & Paper (+6.5%). The worst performing sectors were Financial (+2.0%) and Infrastructure (+2.2%).

Sources: UBP, Bloomberg Finance LP, JP Morgan

Performance Review

- Over the quarter, the fund returned 6.65% gross of fees compared to 5.54% for the JP Morgan CEMBI Diversified index.
- Duration actively managed and moved from 1yr short to a 1yr long to position in a market with higher risk appetite at the end of the quarter. Outperformance mainly came for duration allocation (+107bps).
- UW in Africa / Middle East (South Africa, Zambia and United Arab Emirates) was the main performance contributor. EM Europe (Hungary and Turkey) and Asia (China and Singapore) also added.
- In terms of sectors, utilities and financials were the best performers, with industrials lagging with a nearly flat performance.

Portfolio Activity

- Over the quarter, we increased our exposure to Latin America and EM Europe. Reduced in Asia and Africa regions.
- In EM Europe, increased exposure to Poland (Financials) and Turkey (Consumer).
- In Middle East, closed the position in Jordan (Consumer) and open one in Israel (Financials).
- In Asia ex Japan, closed the position in Singapore (Financials) and initiated one in Malaysia (TMT).
- In Latin America, exposure was increased in Mexico, Colombia and Brazil, reduced on Chile across various sectors.



Outlook

- We expect a Goldilocks environment that is encouraging for the EM asset class as we enter 2024. Since late Oct 2023 our call has been that global financial conditions have reached their peak and that there was no need of additional hikes from the US Fed or the ECB. These central banks will let higher real rates do the tightening job going forward as inflation expectations decline.
- The growth outlook for the US and the EU is for a slowdown. In such a Goldilocks environment (“not too hot, not too cold”) EM corporate fixed income is set to thrive supported by stabilizing to moderately declining US Treasury rates, companies’ much stronger credit metrics vs its US and European peers, and positive technicals as investors have been under allocated the asset class since the beginning of 2022 and will be attracted to lock-in the high yields that the asset class is offering now that US rates’ hiking cycle is over. Our sensitivity analysis shows potential returns in the range of 6.5% to 7.5% for EM Corporate IG asset class, on the back of high carry, additional moderate declines in US Treasury rates and some moderate additional spread compression.
- On aggregate EM corporate credit metrics and fundamentals remain solid and going into 2024 will be supported by easing inflation pressures and gradually decreasing financial costs in the margin as various EM countries have already started easing monetary conditions or are expected to start lowering interest rates in the short term. Additionally, China stabilization is positive news for EM companies. China is flying on 1.5 engines, real estate bottoming, services and consumption bouncing and Chinese exports growth to continue to be restrained by nearshoring trend into Mexico and Latin America more broadly.
- Given the high intrinsic carry, the expectation of some additional spread compression and US base rates tightening, expect returns north of 6.5% for hard-currency EM IG corporate bonds.
- A clearer landscape of the US Fed and the ECB monetary policy paths shall entail reduced uncertainty and volatility in global and EM markets. Risk appetite has been muted throughout 2023 on the back of the uncertain monetary policy tightness coming from the Fed and the ECB. As the global environment becomes less volatile, investors shall be moving out of cash to chase high single digit returns.
- With DM slowing down into 2024, expect more demand for duration than equities. In a juncture of tightening monetary conditions, fixed income assets have been at the mercy of volatility and repricing. The current initial conditions of downward inflation expectations and slowing demand suggest that duration instruments should be the preferred asset class. Amongst FI assets EM debt has the strongest technical position as it has remained an underweight since Covid.



ESG Metrics

- At the end of Q3, the overall **ESG Quality Score** of the portfolio was 19% higher than the index, standing at 6.3 (equivalent to an MSCI ESG Rating of A) vs. 5.3 for the index (equivalent to an MSCI ESG Rating of BBB)

Source: @2023 MSCI ESG Research LLC - coverage: 91% for the fund and 86% for the index.

KEY INDICATORS

- The **weighted average carbon intensity**¹ of the fund is 53.5% below its index, at 274 tons CO₂e/\$M sales revenues v. 589 tons CO₂e/\$M sales revenues for the index.

Source: @2023 MSCI ESG Research – coverage by number of issuers: 91% for the fund and 90% for the index.

- **International norms:**

- Violation of UN Global Compact: 0% (vs. 0.8% in the index)
- Violation of Human Rights norms: 0% (vs. 0.8% in the index)
- Violation of Labour norms: 0% (vs. 0.4% in the index)

Source: @2023 MSCI ESG Research - coverage level: 89% for the fund and 87% for the index

- **Board Independence:** 77.4% of the portfolio is invested in companies that have a majority of independent board members, vs 74.2% for the index.

Source: @2023 MSCI ESG Research - coverage level: 89% for the fund and 84% for the index

- **Board Diversity:** 92.6% of the portfolio is invested in companies that have at least one female Director, vs 87.8% for the index.

Source: @2023 MSCI ESG Research - coverage level: 89% for the fund and 84% for the index

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