UBAM – EM SUSTAINABLE CORPORATE BOND

Quarterly Comment

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

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%.
- Volatility picked up over the quarter, but overall, EM corporate bonds remained well supported as investors remained comfortable with credit fundamentals. Inflows into the asset class were strong (+USD 29.1 bn into EM hard currency bonds, of which +6.8 bn in pure corporate-focused funds vs. 5.3 bn in pure sovereign-focused funds) even if these flows slowed in March.
- This led EM corporate bond spreads to tighten over the quarter by 33 bps to 283 bps.
- Total return performance was negative (-0.99%), however, as a result of the rise in US rates. Still EM corporate bonds were less impacted than EM sovereign bonds (-4.54%), thanks to their much shorter duration (5 years vs 8 years).
- High Yield bonds outperformed, posting a marginally positive return (0.02%), thanks to their higher carry, lower duration and greater spread tightening over the period (-46 bps to 435 bps). Investment grade bonds, in contrast, returned -1.72% with a spread tightening of 32 bps to 177 bps.
- At a regional level, the best performance came from Africa (1.2%) and the Middle East America (-0.2%). In contrast, Latin America (-2.8%) and Europe (-1.1%) underperformed.
- At a country level, the best performance came from Ghana (+15.6%), followed by Azerbaijan (+4.2%) and Bahrain (+4.0%). In contrast, the worst performance came from Mexico (-4.3%), Argentina (-4.0%) and Kazakhstan (-3.6%).
- At a sector level, 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.
- Over the quarter, the performance of EM Sustainable corporate bonds (-0.8%), as measured by JP Morgan ESG CEMBI Broad index was slightly better than that of the overall EM corporate bond universe.

Sources: UBP, Bloomberg Finance LP, JP Morgan

On April 1, 2020, UBAM – EM Sustainable High Grade Corporate Bond was renamed UBAM – EM Sustainable Corporate Bond. On June 8, 2020, the fund widened its investment guidelines to include HY issuers.

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 -1.30% net of fees compared to -0.95% for the JP Morgan CEMBI Diversified index*.
- Performance attribution shows that the fund benefited from its duration positioning but suffered from its issuer/issue selection.
- The main source of our underperformance is our underweight in high yield (especially in the single-B segment), which is constrained by the fund's high ESG quality objective .
- Excluding the duration and curve effects, which are managed at the overall portfolio level,
  - Country-wise, the best performance came from our overweight and selection in China, underweight in Argentina and selection in Chile and Hong Kong. In contrast, our underweight and selection in the UAE. zero holdings in Ghana and the Philippines and selection in India proved costly.
  - Sector-wise, the fund benefited from its selection in Industrials and Financials. In contrast, our underweight in Consumer companies and selection in TMT, Oil & Gas and Metals & Mining proved costly.

**Index provided for comparison and information purposes only. The fund has no official benchmark.*

Portfolio Activity

- Over the quarter, we increased exposure to Asia and Europe, at the expense of Latin America.
- In Asia, we primarily added holdings in Korea (Financial company – sustainability bond; Industrials – green bonds), India (Utilities – green bonds), and China (TMT, Real Estate – green bond).
- In Europe, we added to our holdings in Turkey (Diversified group) and Ukraine (Consumer).
- In Latin America, we reduced our exposure to Mexico (Industrials).
- We continued to increase the share of green and sustainability bonds in the portfolio (10.2% vs. 6.2% at the end of December 2020 and 3.8% in the index).
- In particular, we bought exposure to the sustainability bonds issued by Shinhan Financial Group (SFG), a Korea's largest banking group rated AA by MSCI. 100% of the net proceeds of the bonds are to be used to finance Green (Renewable Energy; Energy Efficiency; Pollution Prevention and Control; Green Buildings) or Social (Access to Essential Services; Affordable Housing) projects. As an external party, Sustainalytics reviewed the bonds and confirmed their alignment with the Sustainability Bond Guidelines. Sustainalytics views that the eligible Green and Social Projects will advance the UN Sustainable Development Goals 7, 8, 9, 10, 11 and 12.

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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 very 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.
- Moreover, with the increased focus of investors and regulators on sustainability, we believe that ESG-minded issuers will benefit from these inflows, which should support further our strategy.

- At a country level, our largest overweight positions are in India, Chile, China, Hong Kong and South Africa.
- Our largest underweights are in Israel, Saudi Arabia, the Philippines, Turkey and Qatar.
- At a sector level, our largest overweight positions are in TMT and Real Estate while our largest underweights are in Financials, Industrials and Oil & Gas.

ESG Metrics

- At the end of the quarter, the overall **ESG Quality Score** of the portfolio was 46.5% higher than the index, standing at 5.83 (equivalent to an MSCI ESG Rating of A) vs. 3.98 for the index (equivalent to an MSCI ESG Rating of BB) (@2021 MSCI ESG Research LLC - coverage: 95% for the fund and 88% for the index)

KEY INDICATORS

- The **weighted average carbon intensity**[1] of the fund is 49% below its index, at 349.5 tons CO2e/$M sales revenues v. 685.1 tons CO2e/$M sales revenues for the index. (@2021 MSCI ESG Research LLC - coverage: 97% for the fund and 92% for the index)
- According to ISS, scope 1,2, and 3 greenhouse gas emissions stand at 22.8% below those of the index. (coverage: 83% for the fund and 77% for the index)
- 56% of the electricity generated from our holdings in the utilities sector come from green power, compared to only 18% in the index. (Source: ISS - coverage: 83% for the fund and 77% for the index)
- **International norms**:
    - Violation of UN Global Compact: 0% (v. 2.6% in the index)
    - Violation of Human Rights norms: 0% (vs. 1.7% in the index)
    - Violation of Labour norms: 0% (vs. 1.1% in the index)

  (source: @2021 MSCI ESG Research - coverage level: 97% for the fund and 91% for the index)
- **Board Independence**: 68.7% of the portfolio is invested in companies that have a majority of independent board members, vs 68.8% for the index.

  (source: @2021 MSCI ESG Research - coverage level: 94% for the fund and 86% for the index)
- **Board Diversity:** 81% of the portfolio is invested in companies that have at least one female Director, vs 68.8% for the index.

  (source: @2021 MSCI ESG Research - coverage level: 94% for the fund and 86% for the index)
- The average **Fatalty** rate stands at 9.5 per 100,000 employees in the fund compared to 21.3 per 100,000 employees in the index. (Source: MSCI ESG Research – coverage 33.6% of issuers in the fund vs. 23.8% of issuers in the index – the coverage ratio depends on the materiality of the indicator).

[1] taking into account subsidiary mapping

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Disclaimer

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