

U ACCESS – CHINA CONVERTIBLE 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

- Investor sentiment has been deteriorating again over the last quarter of the year. Concerns over weaker growth in China and worries that stimulus measures announced by the Chinese government may not have enough impact on the economic activity. This combined with the ongoing real estate crisis weighed on Chinese assets. We saw some signs of improvement in October and November with higher Retail Sales and higher industrial production, but it did not lead to a reversal in the negative momentum affecting Chinese stocks. In this market environment, private-owned enterprises globally underperformed State-Owned Enterprises, -6.3% vs. -5.5% (CNH, total return) respectively.
- For the quarter ending 27th December 2023, China's domestic stock market (hereafter the "A-share market") fell by 9.0% (CSI 800 Total Return Index). For purpose of comparison, over the same period, Hong-Kong-listed mainland securities (the Hang Seng Index, HSML100) was down -10.1% (CNH, total return).
- Over the past three months, except Utilities (+1.2%), all sectors were in negative territory. In this downward market environment, the 3 most resilient sectors of the A-share market were Energy (-0.5%), IT (-1.2%), and Healthcare (-2.0%). At the bottom-end, Real Estate (-21.1%), Industrials (-10.6%) and Financials (-8.3%) reported the most negative returns q/q.
- During the fourth quarter, convertible bond issuance in domestic China totalled CNY 10 billion through 45 new convertible issues. At December-end, they are 545 tradable convertible bonds in the Chinese onshore market, for a total outstanding amount of CNY 999 billion.

Performance Review

- In Q4, the strategy decreased by 5.2% (U Access – China Convertible Bond IC CNH), below the on-shore convertible bond market (CSI Convertible Bond Index) by 1.0%*. This brings the performance since 27th december 2022 to -3.1% by the 27th December 2023. Sector-wise, most of the underperformance is coming from our overweight in Industrials, Materials and Consumer Discretionary. Overall, our bond selection contributed 30bps to our relatively performance while sector allocation detracted 134bps.
- The Chinese equity market fell over the quarter on the back of continuous economic difficulties, being down 9.0%. Over the same period, the on-shore convertible bond market (CSI Convertible Bond Index) fell only 4.2%.

Portfolio Activity

- The investment level of the U Access – China Convertible Bond portfolio remained above 95% for the whole period under review. In comparison to the investment universe, we maintained an underweight exposure to the Financial sector in accordance with our systematic approach which aims to ensure sufficient portfolio diversification. For purpose of indication, the portfolio's exposure level to the Financials sector was on average 14%, compared to an average weight of 31% for the universe. Likewise, the cumulative weight of the portfolio's top 10 holdings remained circa 10% (vs. 28% for the investment universe).

*Quarterly performance calculated between the 25th September 2023 and the 27th December 2023. Index is for reference purposes only and no comparability or relevance is warranted or implied. For indicative purpose only, the strategy has no official benchmark.

- In terms of risk profile, throughout the quarter, the portfolio maintained greater allocation to both the “balanced” and “higher equity sensitivity” segments than the investment universe, and an underweight positioning to the “bond-like” segment.
- At December-end, the portfolio exhibits an average equity sensitivity of 52.6%.

Outlook

- We expect Q4-23 GDP to reach 5.0% y/y, below consensus expectations of 5.3% y/y. This means that China should be well on track to meet its 5.0% growth target for 2023. November data pointed to uneven economic recovery, but we noted improved Retail sales +10.1% y/y and higher industrial production +6.6% y/y. We have kept our 2024 forecast unchanged at 4.5%. Private sector investment will likely remain subdued in 2024, dragged by a contraction in China’s massive housing sector (20% of GDP). The silver lining is that we expect policy measures to fuel a stabilisation in real estate sector investment in H2-24. Together will strong performance across “new economy” sectors (12% of GDP), such as Electric Vehicles (EVs) and high value-added manufacturing, this should help to support a broadening in China’s economic recovery. More easing is still required to stabilise activity. Fiscal policy stimulus will take over from monetary policy stimulus in 2024, although both will have to be deployed in 2024.
- A-share equities are still trading at a 5Yr Cyclically Adjusted Price-to-Earnings ratio attractive level of 11.9x (vs. 15.3x historical average). To our view this could represent an attractive entry point for long term investors. However, the high volatility associated with A-shares has historically been a drawback when considering exposure to onshore China. Thanks to their dual nature, convertible bonds give investors access to A-shares with lower volatility and reduced drawdown risk.
- The Chinese onshore convertible bond market offers access to companies and sectors with a direct or indirect exposure to the growing Chinese consumer’s demand. In our view, these constitute a fertile hunting ground as China moves to its era of “common prosperity”.
- Our U Access – China Convertible Bond strategy follows a systematic selection & allocation approach. The latter has been designed to provide investors with a liquidity-enhanced and diversified exposure to China’s on-shore convertible bond market, which is capable of navigating the A-share market’s bouts of volatility, as evidenced by the outperformance achieved by the strategy since its inception compared with both the equity market and the convertible bond universe.

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