UBAM – MULTIFUNDS FLEXIBLE ALLOCATION

Quarterly Comment | Q1 2023

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Market Comment

- Stock markets recorded broad gains over the first quarter of 2023, with the MSCI ACWI* climbing 7.31% over the period, but not without considerable volatility along the way as January started off very strong on the back of China re-opening optimism, while February saw increasing concern about further rate hikes because of very strong economic activity and higher than expected inflation figures. However, a sudden bank run at a regional US bank at the beginning of March quickly spread apprehension in the financial sector globally, completely shifting the market outlook for interest rates in the process and sending the markets into panic for two weeks. Fortunately, coordinated efforts by regulators and banks helped alleviate fears of a domino effect and prompted a rebound that extended through to the end of the quarter.
- The Fed's governors still decided to increase the Fed funds rate by a further 25 basis points in March, taking the benchmark fed funds rate to a target range between 4.75%-5%.
- Sectors that are negatively exposed to interest rate sensitivities and that sit firmly in the growth investing bucket such as information technology, communication services and consumer discretionary outperformed significantly in the first quarter, with the MSCI World Growth index* up 15.10% over the period. Whereas inversely, defensive sectors such as energy, health care, utilities and financials clearly underperformed and the MSCI World Value index* closed the quarter up 0.92%. In terms of size, small caps outperformed their large caps counterparts for most of the quarter on better optimism but significantly underperformed in the face of panic.
- In terms of region, Europe had the best performance with the MSCI Europe* returning close to 8.61% over the period, while the S&P 500* as a US proxy was up 7.36% and the MSCI EM* was up only 3.96%. US dollar weakness helped Europe and emerging markets alike gain some ground at the beginning of the quarter, but Europe solidified its lead when geopolitical tensions between the US and China resulted in a pullback in the Chinese tech rally.

Sources: UBP, Bloomberg Finance LP.

Performance Review

- The first quarter of 2022 saw positive absolute returns of 4.40% (USD, Institutional share class). Performance relative to the composite benchmark was slightly negative over the quarter.
- Cash as a fixed income substitute and slight underweight equity had a negative impact on performance.
- Manager selection was negative within both buckets, equity and fixed income.
- JP Morgan Global Bond Opportunity and BGF Sustainable Fixed Income within our fixed income bucket suffered the most for the asset class. A shorter duration stance did hurt for both.
- With regard to equity allocation, manager selection in Emerging Markets was poor during the quarter and so was our Climate change and Environment fund selection.
- Our Global Ethical Value manager selection contributed positively which did offset the style allocation.

Portfolio Activity

- During the quarter, portfolio activity was low as preference was maintained to capitalise on a conviction-based portfolio.
- We increase energy transition over the quarter while slightly reducing other positions. Valuation have come down and we saw a good entry point
- During the first quarter we also increased Fixed Income manager selection within Emerging.

Sources: UBP, Bloomberg Finance LP.

Outlook

- In the first quarter of 2023 a recession was averted by the global economy with major developed markets proving more resilient than expected. Demand remained robust and mainly driven by services, whilst supply conditions continued to improve, enabling a stabilization of the manufacturing activity downturn. As a result, recession risks eased in the first part of the quarter, with PMI indicators providing evidence of economic strength and improved outlooks across major economies throughout the quarter. In March, financial news of the failure of Silicon Valley Bank and the takeover of Credit Suisse by UBS drove bouts of financial market volatility amid heightened uncertainty. Although these were isolated cases and rather unique situations, they led to increased concerns among market participants regarding bank portfolio losses, deposit flight, and contagion risks. Several statements and liquidity support measures from central banks helped to reduce market fears herein however, with sentiment improving towards the end of the quarter. Despite the banking crisis being contained, recent developments could result in a faster and more pronounced tightening of financial conditions through tighter lending standards which will need to be monitored.
- According to central bank surveys, lending and credit conditions were already tightening before the recent market stress. This suggests that any acceleration or intensification in tightening standards could translate into more adverse macroeconomic consequences, posing risks to the recently improved economic and inflation outlook for developed economies. Inflation could now ease faster than anticipated as the reduced availability of credit and tighter borrowing conditions weigh on households and business demand, employment and prices. Inflation continued to decelerate in the first quarter of the year and even more so towards the end of it as base effects on the energy front kicked in. Core inflation remains well above target amongst most economies, supported by services and tight labour market conditions. Looking ahead, financial news aside, global inflation is expected to ease further, benefitting from base effects on commodity prices, cooling demand, and improving supply chain conditions. Wage pressures are also expected to ease as unemployment rates begin to rise on the back of weaker growth, helping a deceleration in service prices. That said, we expect for some volatility to persist meaning that the path towards lower inflation may not be a linear one. Overall, the strength of labour markets within DM economies combined with resilient growth from Asian countries should support global growth this year, which we expect to remain solid and above 2%.
- Equity markets have begun 2023 in cheerful mood, but March 2023 was a month of divergent returns depending on theme and geography. Investors demonstrated a strong preference for large caps and technology, and leadership proved to be very narrow, for example 88% of the S&P's advance in March was derived from 10 tech names. The switch of market leadership from Value to Growth follows a well-trodden playbook where one period's share price leaders become the next market phase laggards.
- So far, investor behaviour in response to lower bond yields, driven by the turbulence in developed market banks, has been to buy growth, yet this is in the face of a quarter when profit guidance overall was as poor as at any time since Q1 2015. The market reaction is perhaps too optimistic, favouring more expensive, growth areas of the market and shunning lower multiple sectors. The team remains positioned in both quality-growth and value managers.
- As active managers, such an environment should very much play to the team's strengths, as quality companies are increasingly sought after, and the valuation sensitivity is rewarded by way of outperformance. The investment team remains very optimistic that their investment approach will be rewarded in the current environment.

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.

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