U ACCESS (IRL) TREND MACRO

Quarterly Comment

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

Market Comment

- The second quarter was very strong for equities and credit as central banks and governments provided enormous amounts of stimulus and economies started to reopen. World equities rallied across the board, up close to 20% on aggregate, with the US and EM leading the way, while Europe and Japan lagged somewhat. In terms of styles, growth continued to strongly outperform value, as we have seen in the last several quarters. Central bank support also helped supporting High Yield which rallied by close to 10% in Q2. EM Debt also rallied as many central banks cut rates, some even implemented QE for the first time, and oil rallied following an extraordinary collapse into negative territory. Despite the strong rebound in risk assets, traditional portfolio hedges such as government bonds and gold held up well. US Treasuries are up about 9% year to date, while gold is up close to 18%.
- The lock down has reduced consumers' spending and led to a surge in savings rates. This provided the liquidity for retail day trading via cheap trading platforms. The retail trading combined with algorithmic systems designed to piggyback on this approach has led to some staggering moves in individual stock prices driven by key words rather than earnings prospects.
- For Macro Managers returns were healthy, but there was a wide spread of returns around this average. Returns were influenced by managers regional focus as G10 focused managers moved sideways, whilst those invested outside of these markets captured gains in positive carry, primarily in emerging markets and the European periphery. This trend continued through May and June and was driven by long exposure to interest rates and sovereign bonds. Gains were offset by FX hedging, which had tended to be long US Dollar and short EM currencies, such as Brazilian real and Mexican peso.
- The current market environment provides a very interesting set of opportunities for our U Access (IRL) Trend Macro fund, which offers access to diversifying risk drivers and exposures by seizing long and short investment opportunities across mainly interest rates, credit and currencies, both in developed and Emerging Markets. It has historically shown a limited correlation to traditional assets.

Performance Review

- For the second quarter of 2020, U Access (IRL) Trend Macro returned +11.95%, bringing the YTD performance to +6.96% (Class B USD, net of fees). In terms of contribution by asset classes, Rates and Credit were strong contributors, while equities and currencies were marginal detractors. Looking at regrions, Emerging Markets, in particular EEMEA, were strong positive contributors, while Developed markets were slight detractors.
- The investment team started the second quarter optimistic of a rebound in economic activity and asset prices due to three main reasons: 1. Unprecedented global monetary and fiscal stimulus deployed by global central banks and governments to combat the COVID crisis, 2. Slowdown in the rate of growth of the new COVID infections and 3. Record deleveraging of risk positions in March. The thesis played out in the second quarter as economies around the world emerged from lockdowns and economic activity rebounded strongly.

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.

- The strategic shift of the portfolio into select Emerging Market credits with strong fundamentals and an IMF backstop, drove credit performance during the quarter. This was led by Ukraine (190bps), Angola (177bps), Ghana (137bps), Gabon (67bps), Tunisia (66bps), Egypt (59bps), and Kenya (57bps). The corporate credit exposure added 238 bps during the quarter. The largest exposure within this allocation is to Chinese real estate. China was the firs country to be impacted by COVID but also the first one to emerge from the lockdown. The rebound in activity as well as the monetary and fiscal stimulus benefitted the housing market.
- Local rates positively contributed to performance as well in Q2, led by Ukraine 2 & 5 year bonds (322bps) and Pakistan 1 year notes (24bps). During the quarter, the team substantially reduced their local rates exposure, as it booked profits and switched to external debt positions which had far superior total return opportunity ahead. It completely sold down local rates positions in Pakistan and Kenya and greatly reduced the positions in Ukraine and Egypt.
- Given the team's discipline of having hedges in the portfolio at all times and the strong risk on move in the markets, shorts in US Equities (-69 bps) and in CDX EM (-62bps) were the main detractors of performance in Q2. As the quarter progressed and the team increased the diversified credit book. It continued to add hedges to protect the portfolio.

Portfolio Activity

- As mentioned above, the main shift in the portfolio in Q2 was the swith out of local currency rates exposure in favor of hard currency government bonds. The investment team added exposure during the quarter to the oil driven economies of Angola, Gabon, Ghana and Tunisia. This was driven by our bullish outlook on oil from an oversold position, along with the commitment to structural reforms and an existing/imminent IMF program. The corporate credit exposure remained stable over the quarter.
- In Ukraine the portfolio started the quarter with 75% of the exposure in local currency bonds and 25% in hard currency bonds. It finished the quarter with 25% in local currency and 75% in hard currency. Ukraine benefited from the passage of land reform and bank reform bills and in June the IMF approved an 18-month Stand-by Arrangement (SBA) with the country thus securing adequate financing and preserving the momentum on continued structural reforms.
- Similarly, in Egypt, the team took profit on part of the local currency exposure while adding to hard currency positions. During the quarter Egypt was able to secure a new IMF program and over $14 billion in financing: $5.2 billion IMF Stand by Arrangement, $2.8 billion from the IMF for balance of payments needs stemming from the COVID pandemic, $1 billion loan from U.A.E., $400 million from the World Bank and had a $5 billion bond offering. The team anticipates another 150-200 basis points of spread compression in local bonds and continues to maintain an allocation. Overall, the team expects to continue rotating away from local currency exposure towards hard currency debt.

Outlook

- The team believes the second half of 2020 will be a tussle between continued economic recovery, risks emerging from COVID resurgence and the US elections in the fall. It remains focused on the pace and continuity of the recovery in global economic activity. May and June saw a V-shaped recovery as the rebound in economic activity surprised to the upside versus expectations. The recovery was supported by unprecedented monetary and fiscal policy stimulus, which led to record low yields and abundant liquidity.
- G3 Central Bank balance sheets will have increased by 20 percentage points of GDP by year-end while real rates are likely to remain negative for an extended period of time as central banks have committed themselves to lower for longer.

This combination of negative real yields, abundant liquidity and recovering economic activity is a recipe for continued reflation of asset prices and a global search for yield.

- While risks remain from a COVID resurgence – the team remains focused on monitoring mortality rates, which continue to drop even as the number of infections are increasing. This is likely due to the fact that the less vulnerable sections of the population are getting infected. For example, the median age of infected in Florida dropped from 65 to 37. Meanwhile, Phase III clinical trials have already begun on a number of promising vaccines and progress continues on the development of therapeutics. Today there is also better knowledge on how to deal with the infection. This leads us to believe that while we may see localized lockdowns, we are not likely to see a 100% shutdown of the economy, unless there is a significant surge in deaths.
- US elections are the main risk to the team's outlook but only under the scenario where Biden wins and the Democrats sweep the Congress. Biden's proposed $4 trillion tax increase, $6 billion spending increase and re-regulation agenda will adversely impact corporate earnings and consequently, risk sentiment. As a matter of discipline, the investment team will not make a bet on the outcome of the US elections but instead focus on risk management heading into the fall.
- The team continue to believe that high yield emerging market credit offers the best risk/reward with potential total returns of over 20% over the next 12 months as asset prices gradually return to pre-COVID levels. There continues to be an unprecedented opportunity for capital appreciation, not seen since 2008, due to forced deleveraging in the credit markets. However, being selective has become even more important as an unprecedented number of sovereigns are likely to default and restructure in the near future. The team is making sure that the countries it selects are fully financed, remain committed to reforms and have continued support from the IMF and other multilateral agencies. It will maintain the discipline in taking profit when asset prices become too rich and total return potential drops.
- The portfolio is positioned in asymmetric reflation trades. As economic activity continues to recover through the course of the year, negative real rates and abundant liquidity is like to reflate economies and, consequently, asset prices. The team has a position in US breakeven inflation swaps which it believes have the ability to adjust higher as the global economy improves.
- The investment team remains bullish on oil in the medium term and favors selective credits that are dependent on oil prices. The demand destruction brought on by COVID has also led to a significant decline in capital expenditure which will make it difficult to meet increased demand in a year from now. It continues to prefer to express this view through positions in Angola, Gabon, Ghana and Tunisia. All of the mentioned countries can service their debt at today's oil price, have sound fiscal finances, strong balance of payments and a good relationship with the IMF. The team's constructive view on oil also supports the reflation trades.
- Managing hedges actively will be particularly important in the second half of the year especially as US elections draw closer. Preferred hedges remain short credit indices and the recent normalization in the VIX is providing an opportunity to re-establish puts on the S&P 500.

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