Q1 2023

UBAM – EMERGING MARKET DEBT OPPORTUNITIES

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

- The year began with positive sentiment on the growth outlook as energy costs fell and China's economy reopened. However, February and March saw US-China tensions re-escalate and a widespread loss of confidence in US and European banks. The Fed hiked rates to new highs and further reduced liquidity. EM has benefited from the shift of relative growth momentum with a rebounding mainland China and surprisingly resilient Europe. EM central banks generally were not constrained by financial stability concerns and remained focus on inflation. The collapse of Silicon Valley Bank in mid-March and the later Credit Suisse bought by UBS in a deal brokered by the Swiss authorities, reduced concerns over re-accelerating inflation. It caused a sharp rally in government bond markets due to fears of a possible banking crisis, where government bond markets went from pricing in rate hikes to discounting sizeable rate cuts. Following the strains on the US and European banking sector, EM Financials conversely did well during the first quarter.
- Emerging Markets bond flows have seen an increase of +$2.1bn since the beginning or the year, where a widening EM-DM growth differential and a more benign dollar supported EM capital flows, according to data and research forecast from JP Morgan.
- EM Local currency debt did relatively better, nearly +5%, thanks to a combination of stronger currencies and lower bond yields.
- Over the quarter, EM Investment Grade corporate bonds outperformed the broader EM Corporate universe, returning +2.02% while their High Yield counterparties returned +1.82%, outperforming the broader index.
- In the EM Corporate IG space, at a regional level, Asia (+2.9%) fared better than others, followed by Middle East and Latin America (both +1.2%).
- At a country level, the best performance came from Malaysia (+4.4%), Thailand (4.2%) and Taiwan (+3.7%). The worst performance was delivered by Egypt (-2.2%), Nigeria (-1.6%), and Panama (-1.4%).
- At a sector level, the best performance came from Diversified (+4.6%), followed by Oil & Gas and TMT (+3.1%). Infrastructure constituted the worst performing sector (+0.8%).
- EM FX largely reflected the improving carry environment, as well as expectations of broader USD weakness, given the uncertainties in the US economy. EM FX Latam with MXN (8.1%), CLP (+7.0%), BRL (4.3%) and COP (5.0%) being the outperformers against USD. CEEMEA with HUF (6.5%), CZK(4.2%) and PLN (1.35%) vs USD.

Sources: UBP, Bloomberg Finance LP, JP Morgan

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

- The fund returned -1.29% net of fees and the attribution report shows + 0.93% in Q1. The main contributor to positive performance was duration positioning (Carry Rate effect + Duration Parallel shift effect). Our credit exposure was the lagger an brought a negative overall effect to performance.
- In terms of instrument types, the main contributor to performance was our sovereign holdings with +2.27% but impaired by the Hedging and FX negative returns -3.13%.
- In terms of countries, our holdings in Mexico, Hungary and Brazil contributed the most to performance. On the other hand, Egypt and South Africa detracted the most.

Portfolio Activity

- In Emerging Europe, we increased exposure in Poland and reduced Romain in sovereign debt.
- In Africa, we reduced Egypt and South African and increased Kenya and Gabon in sovereign debt.
- In Asia, reduced in Malaysia (consumer), Philippines (sovereign debt), Indonesia (TMT) and India (Financials)
- In Emerging Europe, we continues increasing our exposure to Romania on the sovereign side and initiated an exposure to Hungary, consequently increasing our overall exposure in the region.
- In Latin America, reduced in Dominican Republic, Mexico, Paraguay, Ecuador and increased in Mexico and Costa Rica in sovereign debt. Also reduced in Chile (TMT), Brazil (Consumer, TMT and Transport) and Mexico (Financials and Industrials).
- We increased our duration, moving the modified duration of the portfolio from 3.36 years as at the end of December 2022 to 8.8 years at the end of March 2023.
- Our main bets on the EMFX side towards the end of quarter were a long RON (5.3%), BRL (5%) and HUF(3.8%).

Outlook

- Although the high volatility in US base rates has been seen a the sharp decrease in yields on the back of financial stability concerns during the first quarter, we think we are close to the end of Fed's hiking cycle and the main part of US base rates adjustment is behind us. The significant market repricing of monetary policy trends for core CB has also led to a reassessment of the next steps for EM CB. Expectations for cutting rates on several EM CB (in LatAm and CEEMEA) in the next year are now higher. For the few countries where further tightening is expected (Thailand, Mexico, and South Africa), markets are pricing a more accommodative stance.
- With regards to EM corporates, as in previous months, the outlook for 2023 is more challenging compared to 2022, on the back of the tighter financial conditions and increased inflation that will exert their full impact on corporates' financials figures during this year. However, on an aggregate level EM IG corporate credit fundamentals remain healthy having deleveraged in past years and having extended their debt maturities at lower interest rates taking advantage of the low interest cycle prior to the quantitative tightening cycle.
- Additionally, EM IG corporate valuations (spreads) look very attractive for the risks implied compared to other regions such as US IG, with almost 100 bps spread pick-up in the case of LATAM IG, for instance. It is worth highlighting that we maintain our OW in LATAM as we continue seeing solid fundamentals and very attractive valuations on a relatively basis vs other EM regions.
- On the other hand, recent movements in local currency debt could open up opportunities and we focus on LatAm, South Africa and India. Overall, EM growth and a stable policy backdrop are positive for EM assets, including hard currency debt. We are monitoring the political environment in Turkey, but do not see insolvency risks. Country selection is essential amid the geopolitical tensions over China and the United States.

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