

# UBAM – GLOBAL HEALTHCARE CONVERTIBLE BOND

## Quarterly Comment

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### Market Comment

- Q4 2022 was characterized by a further slowdown in global growth and emerging signs of peaking inflation across developed economies. During the fourth quarter of the Federal Reserve had been sending signals to prepare the market for a slowdown in the pace of rate hikes and, after four consecutive 0.75% hikes, it rose its key rate by 0.50% in December. The Federal Reserve increased its policy rates totaling a 125bps hike from 3%-3.25% to 4.25%-4.50%. Over the quarter, the US 10-year rate rose by only 4bps to 3.87%. Despite the return of volatility during December, global equity markets ended Q4 in positive territory. Credit spreads tighten during Q4 for both IG and HY down by 29bps and 64bps respectively.
- Eventually, global equities ended the quarter up 9.8% (MSCI World TR), bringing their performance over 2022 to -18.1%. In the US, the S&P 500 index increased by 7.6% quarter-on-quarter. In terms of investment styles, there was an outperformance of the Value segment over the Growth (13.6% q/q for the S&P Growth index, 12.2% ahead of the S&P Value index). The Healthcare Select Sector Index rose by 12.8% over the quarter, 5.2% above the broad S&P 500 index. The US healthcare convertible bond market, however, lagged its equity counterpart. During the quarter, the ICE BofA US Healthcare Convertible Index increased by 3.7%.
- Primary market confirmed the rebound seen in Q3 as global markets introduced \$13.2 billion of convertible bonds during the last quarter of the year. The US contributing \$8.9bn. After two record years, the decline in 2022 was sharp. Overall, in 2022, global convertible issuance is still relatively low and totalized \$39bn including \$28.5bn in the US. Together, the Healthcare sector contribution reached \$7.6bn or 19% of the total amount issued 2022.

### Performance Review

- During the 4<sup>th</sup> quarter, the UBAM – Global Healthcare Convertible Bond Fund (IC USD) returned +2.9% after fees, bringing the performance since the beginning of the year to -13.1%.
  - For the period under review, the healthcare theme delivered a performance above the broad US equity market, as revealed by the US healthcare equity index<sup>2</sup> (12.8% vs 7.6%).
  - The “structuration” – namely, the choice of convertible bonds to get exposure to the healthcare stock market –, however, came at a cost this quarter, as evidenced by the 7.9% underperformance of our Healthcare Convertible bond universe vs. the healthcare stock index. The ICE BofA US Healthcare stock index<sup>1</sup> was up 3.7% q/q.
  - This quarter, the positive performance of our strategy comes from the strong of Healthcare stocks over the quarter.
- At firm level, top contributors over the quarter were Dexcom (Healthcare Equipment & Services), Exact Sciences (Pharmaceuticals, Biotech & Life Sciences) and Alnylam Pharmaceuticals (Pharmaceuticals, Biotech & Life Sciences). On the opposite end, holdings in Guardant Health (Healthcare Equipment & Services), Inmed (Pharmaceuticals, Biotech & Life Sciences) and Omnicell (Healthcare Equipment & Services) detracted.

<sup>1</sup>For indicative purpose only, the strategy has no official benchmark. <sup>2</sup>The Healthcare Select Sector Index (USD).

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## Portfolio Activity

- Within the UBAM – Global Healthcare Convertible Bond portfolio, the fourth quarter was marked by:
  - Liquidity-related adjustments (e.g. Ascendis Pharma 2028; Envista Holdings 2025, Integra Lifesciences 2025, Supernus Pharmaceuticals 2023)
  - Credit related trades (e.g. Alphatec 2026, Cryoport 2026, Guardant Health 2027)
  - Accounting quality-related trades (e.g. Ascendis Pharma 2028, Innoviva 2028, Teladoc 2027)
  - Security financing-related trades (e.g. Oak Street Health 2026, Biomarin Pharma 2027, Cytokinetics 2027, Jazz Pharma 2024)
  - Additions to the investment universe and portfolio (e.g. Nextgen Healthcare 2027, Lantheus 2027)
- During the quarter, the portfolio reported a turnover of 112% with an average realized beta versus the Healthcare equity index of 0.5
- At December-end, UBAM – Global Healthcare Convertible Bond exhibits an expected beta of 0.4 versus healthcare equity index with nearly 3/5 of expected Healthcare equity index volatility.

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## Outlook

- The year 2022 will be remembered for the sharp rise in short and long rates that penalised all asset classes. Although several developed economies are on track to experience further economic weakness this year, recent evidence suggests that the overall impact could be smaller than previously anticipated. 2023 should see a lull in the rise in short rates, while maintaining strong tension on long rates. Markets are likely to be less directional and less adverse. Dispersion could be particularly high in the equity markets.
- Despite being down in 2022, healthcare convertible bonds are outperforming global convertibles. Against a deteriorating economic backdrop, offering a defensive play, Healthcare is increasingly attractive as valuations have collapsed. On average the Price-to-sales ratio has fallen by 60% since their 2021 highs for convertible issuer in the technology sector. The cyclical shift that impacted global equity markets does not question the long-term case for the healthcare industry. If anything, the Covid-19 pandemic has **accelerated the spread of trends for which the long-term fundamentals remain unchanged** (expanding basic health insurance; evolving care models; ageing world population; rising chronic disease...). Fierce therapeutic and technological innovations lay the **foundation for sustained, and new, growth channels in the healthcare industry** (e.g. big data insights to predict outbreaks; artificial intelligence to improve diagnostic accuracy; gene therapy and editing). Overall, at current level we see an **attractive entry point into the healthcare convertible bond space**. We believe Healthcare sector should perform better thanks to reduced upside pressure on interest rates in 2023.

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