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 first quarter of 2020 has not been an easy one for investors and will be remembered for a long time. Global equity markets were down -20.0% during Q1, as measured by the MSCI AC World - Net Return Local Index, almost erasing the entire gains of 2019. Some markets had the worst quarterly performance since 1987. The most notable was the speed and steepness of the decline, with all losses occurring in a four-week span between February and March, as the uncertainties related to COVID-19 triggered an indiscriminate sell-off across the board, exacerbated by a massive deleveraging of several market participants. Peak-to-trough, most markets were down over -30%.
- Developed Market (DM) equities fell sharply, in line with global markets. The Japanese Topix lost -17.5%, the S&P 500 was down -19.6%, while Europe was hit the hardest with the MSCI Europe down -23.1% in Q1. There was a lot of dispersion within both styles and sectors, as investors tried to assess the impact lockdowns would have on different parts of the economy. In that context, small caps, REITs and, to a lesser extent, value strongly underperformed, while growth strongly outperformed. In terms of sectors, IT and healthcare strongly outperformed, while energy and financials suffered.
- Emerging Market (EM) equities underperformed DM during the quarter, with the MSCI EM TR Index down -23.6%. Here again, a flight to quality triggered a very strong sell off in all EM assets, that sometimes became illiquid, further accelerating the price drop. In general, Asian markets were able to resist better while Latam and MEA suffered significantly.
- Volatility spiked to levels last seen during the 2008-2009 GFC, even surpassing it slightly. As for equities, it is the violence of the move that was notable, as the VIX went from 14 to 82 in one month. It ended the quarter at 53.5, almost 4 times higher than it's close of December 31st, 2019.
- Oil collapsed by -66.5% in Q1 (WTI), one of the worst quarterly percentage drops on record, as Saudi Arabia and Russia went into an all-out price war with unprecedented production increases. At the same time, demand tumbled as countries ordered lockdowns and imposed strict travel restrictions. Gold rallied along with other safe heaven assets, as DM interest rates were cut to zero.
- An unprecedented shock requires an unprecedented policy response, and that is what we have seen. Governments like the UK and Germany have committed to pay a significant proportion of workers' wages during the shutdown to enable companies not to lay off staff. In the US, a very substantial fiscal stimulus package has been agreed, worth about 10% of GDP, which will include some grants to small businesses. Central bankers have thrown the kitchen sink at the problem, cutting rates to their lower bound and restarting and expanding asset purchase programmes to unlimited levels. The depth and duration of this recession will therefore depend on the extent to which governments fill in the gaps in their current fiscal responses.
- The market dislocations witnessed in Q1 should provide 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.

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

- For the first quarter of 2020, U Access (IRL) Trend Macro returned -4.24% (Class B USD, net of fees). In terms of contribution by asset classes, Rates and Credit contwere detractors, while equities and currencies were positive drivers. Looking at regrions, the Emerging Markets exposure was negative while Developed Markets investments showed a positive contribution.
- The sell-off in markets began in February, and accelerated into March, as COVID-19 became a worldwide pandemic and markets started to price in an extraordinary and uncertain economic slowdown. This was exacerbated by a breakdown in talks between Saudi Arabi and Russia on oil production cuts. As a result, March was a month of extreme volatility, with desperation for liquidity and cracks began to appear in funding markets around the world, reminiscent of 2008. The Fed and other central banks stepped in aggressively and decisively, followed with a fiscal response around the world. Under this extreme volatility, two high-conviction positions in the portfolio, namely the exposure in Ukraine and Chinese real estate corporate credit, sold off aggressively and hurt the portfolio adversely, As the investment team had cautiously positioned the portfolio at the beginning of the year, the strategy was able to profit in January and February. However, it gave back returns in March as a result of the market turmoil.
- The brutal sell-off in March across Emerging Markets, had a sharp impact on the fund's performance within the EM local currency rates & FX book, reversing the gains this bucket had seen in the first two months of the year. The best prepared economies in this bucket did best, led by Egypt. Ukraine was the biggest detractor to the portfolio with a contribution of -330bps, driven primarily by currency losses on the front end and duration losses at the long end. Egypt witnessed nearly half the capital foreigners had invested leave during March. The Egyptian central bank sold them dollars from reserves and ensured an orderly process. In aggregate, Egypt rates exposures contributed positively (+60bps). Elsewhere, exposure in Pakistan had a negative contribution of -60bps, as the currency sold off on the back of the Central bank cutting interest rates sharply, to stimulate the local economy.
- In credit, a sharp sell-off in the fund's exposure to Chinese real estate corporate credit in March caused a -220bps impact to the portfolio. The sell-off in March caused the credit position in Ghana to lose -40bps. These were offset by positions in CDX HY that contributed +150bps. Short positions in Argentina credit were also profitable, contributing +60bps.
- During the months of January and February, markets were strong, and liquidity flooded into emerging markets. During that time, the investment team actively shorted US equity markets to hedge the risk in the portfolio. During the month of March, as volatility got extreme and bid-ask spreads widened, it became impossible to use this exposure as a hedge. The position contributed +60bps over the quarter.

Portfolio Activity

- There are two important elements of portfolio construction that the team is implementing in the fund. Firstly, they believe that with these elevated levels of volatility and wide bid-offer spreads, it does not make sense to run a hedged risk-on/risk-off portfolio, as it would usually do. Hedging has become both difficult and very expensive. Central bank interventions can be dangerous for shorts. So during this period of elevated volatility, every position in the portfolio should be viewed as an alpha position, whether long or short.
- Secondly, it considers every position in the portfolio from the perspective of sharp capital gains. It does not think it makes sense in this environment to hold positions for extended periods to capture carry. Lastly, to ensure that it can actively participate in these dislocations, the team has created substantial levels of liquidity in the portfolio.

- The investment team has been taking capital away from a T-Bill position in Pakistan, one of the fund's largest position as a percentage of capital. The Central bank has aggressively cut interest rates from 13.5% to 10% and in this return rich environment, that is less attractive, even though the team likes the policy mix in the country.
- In Ukraine, the team has been reducing exposure in shorter duration local debt and is focusing on longer duration paper. 5-year Ukraine bond yields rose from ~ 9% in mid-January to over 20% at the peak of the volatility. The IMF continues to support the country, the central bank has been cutting rates and is expected to continue doing so. While this was the most painful part of the portfolio in March, the team would expect to see capital gains generated here, that should sharply exceed losses experienced in March.
- It is a similar story in Egypt. The Central bank has cut interest rates by 300 bps. Longer duration bond yields have increased from 13.5% to 15%. Nearly half the capital has fled the country. The IMF has provided additional support and the Egyptian central bank, released reserves and ensured that the capital flight had minimal impact on the exchange rate. This augurs well as capital, when it returns, will prefer countries like Egypt. The fund's exposure has shifted to longer duration local fixed income here, with the objective of capital gains as bond yields should decline, when markets somewhat stabilize.
- Finally, the team is also reducing/eliminating rates exposure in Kenya and Indonesia.

Outlook

- There were two enormous shocks in Q1, the oil shock and the virus shock. And because of social distancing and quarantining, there has been a sudden stop in economic activity. It is anticipated that US GDP could decline by 30% in the second quarter. Equity markets were hit by those shocks and triggered deleveraging, margin calls and more deleveraging. US Treasuries rallied and fixed income funds experienced outflows of over $100bn in Q1. There was also a large unwinding in risk parity and volatility funds while option flows on the third week of March exacerbated market stress. The team believes that those elements indicate that the bulk of the intense de-leveraging is behind us.
- How will markets heal from here? Monetary policies are going to be a 'big bertha' geared to ensure that no systemic problems emerge. Market support has to come from the funding markets, limiting dollar shortage, assuring that the repo market, commercial paper, ABS, high yield and ultimately the treasury and mortgage markets start to behave normally. These markets basically represent the plumbing of the global financial system. All the various measures introduced by the Fed in the last few weeks are designed to do exactly that. All the global central banks have either done Q.E. or other liquidity measures to help markets. The fiscal loosening has also been massive, and it's designed to put money in the bank in the pockets of borrowers who for a period of time may face reduced incomes, or to protect small businesses who may have no incomes for a couple of months because of closures.
- In emerging markets, the IMF has about $1 trillion of lending capacity available on its balance sheet, including $50 billion in rapid disbursement facility to deal with natural disasters precisely like this. This time around what is different from other crisis is that the global banking system is in the best health it's been in years, even the Italian banks have done tremendous work in taking care of their non-performing loan problems. So, by this measure, markets are pricing in a four to six quarter recession at the end of the quarter.

- In terms of the length of this recession, the investment team now believes the actual recession will only be about two quarters, i.e. that there will be a gradual rebound in growth in Q3 and Q4. The team does think that markets are in a bottoming process. In recent weeks there has been a sharp rally. The ultimate low for markets could easily be 10 percent lower from here in equities, as sentiment around the strength of the recent rally and the uncertain economic environment play into investors' minds. But the team does not expect another dizzying sharp correction from here.
- The area where the team is seeing opportunities is in credit. It has already increased exposure in quasi-sovereign paper in Ukraine and Ghana. Chinese real estate credit has been one of the worst affected assets in this sell-off. A number of Asian investors had invested in these bonds through structured / leveraged notes. These notes were de-leveraged during the market sell-off and some of the bonds in the fund saw their yields increase from single digit levels to over twenty percent. The team has actively rotated exposure towards its highest conviction names. The China real estate book has a duration of less than three years and a yield in excess of twenty percent. These companies are already seeing sales activity building. The Chinese central bank has added powerful monetary stimulus. The companies that have been selected have more than adequate cash on their balance sheet to support two years of principal and interest payments.
- The investment team is also actively looking across the Emerging sovereign credit spectrum. Allocation to Ukraine and Ghana within the quasi-sovereign space has already been increased and capital allocation in this part of the portfolio should continue to increase as the team is seeing a lot of dislocations there.

Disclaimer