UBAM – GLOBAL CONVERTIBLE BOND

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

- Reflationary pressures and the cyclical rotation remained pressing topics in Q2. The higher growth parts of the market, however, regained vigor starting mid-May as the uptrend in the US long-term rates experienced some volatility. Solid M&A dynamism in these fields, along with strong earnings reports, also helped fuel the rebound.
- Eventually, global equities ended the quarter up 7.9% (MSCI World). In the US, the S&P 500 index closed the quarter up 8.5% and the Nasdaq 100 +11.4%. In Europe, the Stoxx Europe 600 progressed by 6.4% q/q. Conversely, the Nikkei 225 ended the quarter down 1.2%.
- After a bumpy start into the year, convertible bonds have been making a comeback since mid-May, buoyed by the rebound in growth stocks and a relative slowdown in the issuance pace compared with Q1's exceptional volumes. The Refinitiv Global Convertible Bond Index (EUR hedged) progressed 3.3% in Q2. Region-wise, the global convertible bond market was led higher by the US, Europe and Asia while Japanese convertible bonds closed the quarter in negative territory.
- Global convertible bond issuance was strong in the quarter: ICE BofA reported $39.6 billion in new convertibles. The US market topped the list with $15.3bn, closely followed by Asia ($15.0bn). Europe saw $8.6bn in volume. Japan issued $0.7bn. Year-to-date, $98.9bn has been priced globally ($55.9bn from the US, $22.2 from Asia, $18.9bn from Europe and $1.9bn from Japan) – an all-time high.

Performance Review

- For the quarter ended 30 June 2021, the UBAM – Global Convertible Bond Fund (IC EUR) returned 2.45%, performing fairly in line with the Refinitiv Global Convertible Bond Index (3.31%). The fund outperformed the Bloomberg Barclays Global Aggregate Corporate EUR-Hedged Index (2.25%). Relative to the broader equity market, convertible bonds remained held back by the cyclical rotation in the first half of the quarter before rebounding strongly starting mid-May. From May 12 to June 30, UBAM – Global Convertible Bond captured the full performance of global equities.
- Holdings in the European (1.09%) and US markets (0.72%) drove the strategy's absolute performance during the period, whereas investments in Asia (-0.06%) and Japan (-0.07%) detracted. In relative terms versus the index, the portfolio's average underweight stance within the US hurt performance. Conversely, our average overweight positioning to Europe proved beneficial.
- Sector-wise, contrasting with Q1 trends, the fund's security selection in Communication, Information Technology and Consumer Discretionary were the main contributors to the strategy's absolute performance whereas Industrials and Utilities detracted on average.
- Over the period, top contributors in absolute terms include Snap (+39bps, US Communication Services), MongoDB (+32bps, US IT) and Sea (+30bps, Asia Communication Services). Top detractors were Southwest Airlines (-39bps, Industrials), Square (-14bps) and Tesla (-10bps, US Consumer Discretionary). Relative to the index, our overweighs in MongoDB, Snap and Shopify (US IT) helped, whereas overweighs to Southwest Airlines and Twilio (US IT), and absence from Anta Sports (Asia Consumer Discretionary) came at a cost.

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.

Portfolio Activity

- At June-end, the average equity sensitivity of UBAM – Global Convertible Bond stands at 55% (-2% q/q), roughly neutral with the global convertible bond market (57% for the Refinitiv Global Convertible Index). The strategy's interest rate sensitivity is low, at 1.6 for a 4-year duration. As of June 30, the portfolio's average credit spread stands at 214bps (-11bps q/q) versus 265bps for the index, reflecting the quality bias inherent to our philosophy.
- From a geographical standpoint, the fund is primarily exposed to equity markets through investments in the US (33%). Investments in Europe account for 15% and Asia and Japan for 7%. Relative to the index, the portfolio exhibits an average overweight stance to Europe (+5pts equity sensitivity) and an average underweigh positioning to the US (-6pts).
- Much of the quarter rebalancing occurred in the US bucket (-4% equity sensitivity q/q) in favor of Europe (+2% q/q), through both "recovery" and "digitalisation" names. In comparison to the US, the European market offers overall better credit profile on top of a differientating opportunity set, including in the higher growth segment: where the US is largely dominated by software companies, consumer discretionary businesses represent a noticeable share of the European's growth bucket. Global convertible primary activity remained sustained in Q2, including from the part of repeat issuers. This allowed us to arbitrate some existing investments towards convertible bonds with more balanced profiles, therefor increasing the overall convexity metrics of the portfolio.
- At single security level, main buys over the quarter include the ROHMC 2024, Country Garden 2022, and JPM / LVMH 2024. Main sales include the Country Garden 2021 (closed), Tesla Motors 2024 (closed) and Deutsche Wohnen 2024 (closed).

Outlook

- As we prepare for a more mature phase of the economic cycle, risks of accrued volatility and short-term drawdowns should increase. Proactive risk management becomes increasingly key to navigating the final stages of the recovery phase. As a result, the case for convertible bonds remains strong and cautions against reading too much into the asset class' lag versus equities in the first part of the year. The equity asymmetric nature of the hybrid instrument makes them compelling assets for those who wish to maintain an equity exposure whilst dialling back their risk a bit.
- Convertible bonds' appeal is equally strong considering rising inflationary pressure for those who wish to maintain bond-floor defensive features. Thanks to their conversion option, convertible bonds have much lower interest rate sensitivity than straight bonds of similar duration. Though lagging equity markets year-to-date, convertible bonds are still outperforming all fixed income asset classes.
- Overall, we see the ongoing "recovery trend" as an opportunity to tactically diversify our investments, rather than a questioning of our long-term focus on quality and growth companies. With the economic cycle set to mature in the coming months, we believe that greater selectivity focusing on fundamentals will become critical again. This should benefit the convertible bond market through its large exposure to innovative companies in high growth segments such as the tech, healthcare or internet & distribution, that exhibit good earnings visibility and robust guidance.
- Although we expect the cyclical rotation still has legs, especially in those regions where the "economy reopening" is still early-stage (e.g. Europe), we stay cautious about the lack of visibility as to how fast their business activity can return to pre-crisis levels. In that respect, the rapid spread of the Delta variant in various parts of the world calls for caution when it comes to stock picking. In this context, we reaffirm our bias towards "quality" companies with strong balance sheet fundamentals.
- The recent record dynamism in convertible bonds' issuance has sparked a broad deepening and renewal of the investment pool, led by the "digital transformation" and "economies reopening" themes. Thanks to their dual nature, convertible bonds give investors the chance to be actively positioned on both themes with much lower volatility and downside risk than direct equity investments offer.

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