UBAM – DIVERSIFIED INCOME 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

- During the first quarter of 2024, the US economic activity has been exhibiting its resilience and strength with the rebound of retail sales and industrial production. The manufacturing ISM moved back above 50 showing the better US economic environment and unemployment stayed unchanged at 3.7%. Inflation measured by CPI fell to 3.1% YoY and the PCE, Fed’s preferred measure of inflation, came out at 2.8%. The US Federal Reserve maintained its interest rates unchanged over Q1. The “Higher for Longer” rhetoric made a comeback over the quarter and rate cut expectations have been pushed to later this year. Three rate cuts by the US Federal Reserve are priced for 2024 vs. six at the end of last year. Jerome Powell’s communication did not change much. They are still “data dependent” and keep a close eye on inflation which is still elevated to them while economic activity and labor markets are not yet facing any weakness. In such environment, we have seen an upward shift in US yield curve and the US 10-year yield reached new YTD highs at 4.32% and ended the quarter at 4.20%. Overall, the 2-year to 10-year part of the yield curve moved higher by 30bps to 40bps.
- In Europe, economic indicators are still showing a weak activity. Over Q1, Manufacturing PMI has fallen again at 46.1, while the one for services showed some slight improvement at 51.5. On the inflation front latest prints were more positive as they have been easing. Headline inflation came out at 2.6% YoY in February when core inflation fell to 3.1% YoY. Unemployment rate in the euro Area is relatively stable at 6.5%. The European Central Bank also decided to keep interest rates unchanged and expressed its cautiousness regarding inflation. German and France 10yr yields ended the month 28bps and 25bps lower at 2.30% and 2.81% respectively.
- Overall, it did not alter the upward trend of equity markets, volatility was stable during the first three month of the year and credit spreads tightened during Q1 2024. IG spreads fell in the US and Europe over the third quarter by 11bps and 23bps respectively, while High Yield spreads were down by 22bps and 43bps respectively. Spreads across emerging market debt sectors have been tightening as well.

Performance Review

- In Q1, the UBAM – Diversified Income Opportunities posted a +0.8% performance after fees (IC USD share class).
- Quarter-to-date, the best contributing segment of the strategy was the core portfolio exposure to Investment Grade credit (+50bps). Our exposure to Emerging Market Debt contributing by 23bps. Our position in CoCos returned 39bps in Q1 2024.
- With the upward shift of the US yield curve, our 4yr-5yr duration exposure detractted to the fund’s performance this quarter by -43bps.
- As the USD apprciated over the quarter, our ex-USD currency exposures had a slightly negative impact on performance quarter to date, by 7bps.

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

- Impacted by the global rise in yields, our portfolio's yield increased over the quarter and stood at 5.9% at the end of March, ahead of the USD cash rate at 5.3%.
- In line with the overall tightening in credit spreads, the portfolio's average spread moved 14bps lower over the quarter to 145bp by the end of March.
- Our exposure to non-USD currencies is slightly higher this quarter, we hold a 1.5% net long exposure to EM currencies. The portfolio holds a 2.1% net short USD exposure as at the 27th March.
- During Q1, portfolio duration has been relatively stable at 4.0.
- The portfolio's average credit rating is BBB+ as of the end of March.

Outlook

- While inflation pressures are easing, it is not yet sufficient to trigger the first rate cut. The strength of the US economy supports the current Federal Reserve wait & see and data dependent approach. As a result, interest rates could stay at current level slightly longer than initially expected. In Europe, central bankers are giving a bit more visibility with a potential first rate cut as soon as June. This should be put into perspective with the strong US economy and signs of stabilization in European economic activity. Furthermore, we recently saw a rebound in PMI indices in the US and some improvement among investor sentiments in Europe. It underpins a new scenario characterized by modest growth and falling inflation. We favor positioning on the short-end and the belly of the curve since the long-end could still be vulnerable to US fiscal issues. We are currently holding an average duration of 4.0. We believe this is the best positioning given the current environment. The curve has been inverted for almost 2 years, but we think it is not sustainable. To our view yield curve normalization is on its way and we expect the 3-5yr part of the curve to offer an attractive risk-reward profile over the medium term.
- We prefer to maintain unchanged the overall level of credit risk given the current tightness of spreads across asset classes. We continue to favour low spread duration and high-quality credit, and, in case of a pullback in credit spreads, we could increase the overall credit risk of the fund as our economic scenario is still excluding a strong recession in 2024. We prefer Investment Grade to High Yield from a risk-reward perspective. We believe bonds issued by financials are offering attractive yields and less duration risk.
- While we believe there are currently attractive opportunities to be found within EM debt exposures, we have been decreasing our exposure to EMD recently. 2024 is an important year for emerging markets with numerous election and outcomes could have significant impact on yields and corporate credit. Within the EM debt sector, we prefer the carry offered by external EM debt to local currency debt.

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