UBAM – EMERGING MARKET CORPORATE BOND SHORT DURATION

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

- US interest rates continued their rise over the quarter; 2-year US Treasuries were up 15bps to 4.43%, while 10-year US Treasuries rose by 5bps to 3.88% as the Fed delivered 125bps of hikes cumulatively in November-December.
- The asset class saw outflows at -$16.4bn in Q4 2022, according to data from JP Morgan. This makes the asset class end the year with -$89.2bn in cumulative outflows. EM Fixed Income funds saw an inflow of $52.5bn in 2021.
- The pace of the rise in US Treasury yields moderated and China reopening plans coupled with the support of the real estate market by Beijing had a positive effect on returns in Q4 2022. EM Corporates bonds delivered +4.91% over the quarter according to the JP Morgan CEMBI Div index.
- Over the quarter, EM Investment Grade corporate bonds underperformed the broader EM Corporate universe, returning +3.05% while their High Yield counterparties returned +7.40%, outperforming the broader index. JP Morgan CEMBI Div spreads over US Treasuries tightened by 59bps to 335bps in Q4 2022.
- At a regional level, Latin America (+7.98%) performed the best, followed by Emerging Europe (+7.61%) and Africa (+5.61%) while Asia and the Middle East returned +4.06% and +2.42% respectively.
- At a country level, the best performance came from Macau (+22.80%), Ukraine (+17.37%) and Morocco (+15.88%). The worst performance was delivered by Philippines (-3.53%), Jamaica (-3.05%) and Singapore (+0.34%).
- At a sector level, the best performance came from Pulp & Paper (+14.69%), Consumer (+11.23%) and Metals & Mining (+8.35%). The worst performers were among the Transport sector (+2.12%) and Financials (+2.70%).
- In the context of EM Corporate bonds, the belly of the credit curve (5-7 years) performed better than the rest of the maturity buckets over Q4 2022, returning +8.0%. 1-3-year EM corporate bonds returned +3.1%, while 3-5-year bonds were at +4.8%, ahead of longer maturity buckets (10+ years).

Sources: UBP, Bloomberg Finance LP, JP Morgan

Performance Review

- Over the quarter, the fund returned +4.14% net of fees. The fund benefited from its high carry. The spread contraction was also beneficial to performance. However, duration detracted slightly as yields rose at the short part of the yield curve.
- In Q4, all contries contributed positively, the best performance came from our holdings in Dominican Republic, Egypt and Peru.
- All sector contributed positively as well. The best performance came from our holdings in Sovereign bonds, Industrials and Telecom.
- Our allocation to HY CDX indices contributed positively with +19bps.

Portfolio Activity

- Over the quarter, at regional level, the team reduced its exposure to the Middle East and Africa while increasing the exposure to Latin America.
- In the Middle East, we decreased our exposure to the UAE (Infrastructure) and completely sold our exposure to Iraq on the sovereign side.
- In Africa, we completely sold the exposure to Kenya and slightly reduced the exposure to Benin, both on the sovereign side.
- In Latin America, we increased the exposure to Colombia (Oil & Gas) and Peru (Real Estate).
- In Q4, we also increased the cash bucket in the portfolio following the Fed tightening. It will allow us to participate to the primary market at the beginning of Q1 2023 which offers attractive yield attributes compared to the secondary market.

Outlook

- The outlook for 2023 is encouraging for Emerging Markets (EM) Debt, especially for active managers.
- Global corporate earnings should come under pressure though potentially less in most EM as GDP growth is expected remain solid compares to a slowing activity in developed markets (DM).
- With the evidence of US inflation starting to cool down, the Fed might slow its tightening policy. This could be a positive for US rates (Hard Currency EM bonds) as well as for local currency but a negative for the USD.
- By starting rising rates in early 2021 for some of them and by hiking decisively, EM central banks have been early movers in adjusting their monetary policies compared to DM and are likely to pause earlier. Moreover, disinflation in EM is materializing faster than expected which should be a tailwind.
- In EM, the sooner than expected Chinese reopening is seen as a positive for GDP growth globally, other Asian countries that could benefit from an increase of Chinese tourism and commodity-based countries in South Africa and Latin America that could benefit from the expected terms of trade improvement once China's economic activity normalizes. Moreover, China policymakers are determined to increase growth this year as measures have been taken to simplify tech regulations and to support the real estate market.
- EM are well positioned to face the new economic cycle with healthy balance sheets and solid credit fundamentals. These were able to refinance their debt in the last few years, lowering their financial expenses and extending their debt maturity profiles. They also benefited from the increase in commodities' prices and from expansive fiscal policies promoted by governments to fight Covid's economic impact. Finally, the reduction of net debt supply in 2022 did more than offset the outflows from the asset class during the year.
- One remaining risk remains the geopolitical developments surrounding the conflict in Ukraine.
- At a country level, our largest overweight positions are in China, Paraguay and Colombia.
- At a sector level, our largest overweights and absolute positions remain are Industrial and TMT.

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