Q1 2020

UBAM - GLOBAL CARRY ENHANCED

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% in Q1. 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.
- In that context, especially with the higher level of volatility, we believe expanding asymmetric exposure through alternative solutions is a smart asset allocation move today. Indeed, an increased market uncertainty and volatility should provide a fertile ground for our UBAM - Global Carry Enhanced strategy, which provides a risk/return profile similar to fixed income, yet with a very different source of returns and decorrelation, and by investing in listed, highly liquid instruments.

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

- Over the first quarter of 2020, UBAM - Global Carry Enhanced returned -6.52% net to investors (I EUR class).
- On a monthly basis, the performances were negative (-0.36% in January, -5.25% in February and -0.99% in March), due to extreme movements to the downside in the quarter, especially in February and March (-19.6% for S&P500 TR, -25.34% for the Eurostoxx 50 TR, -23.83% for FTSE100 TR and -19.23% for the Nikkei 225 TR) which hurt our carry strategy given the magnitude of the move.
- On the other hand, as the market was going down the volatility was reacting. VIX futures performed +208%, and Vstoxx futures gained +279% over the quarter. This spike of the volatility benefited to our Tail Risk strategy which compensated part of the loss of the carry strategy, especially in March.
- Finally, -20bps of gross contribution were generated by the EUR Treasury Bills book, where most of the cash holdings were invested for optimisation and UCITS diversification restrictions.

Portfolio Activity

- Within the Carry strategy, which represents 90% of the portfolio allocation, the quarter began with a bullish positioning overall. Signals remained stable during January and February, and turned slowly bearish around the end of February, to finish Q1 2020 in a bearish positioning for all sub regions.
- Within the Risk Management strategy, which represents the remaining 10% of the portfolio allocation, US and Europe sub-strategies evolved in the same way. The exposure to volatility futures was lean in January when signals remained at their floor. In Early February, both signals started to increase then came back to the floor a few days later. Finally, around February 18th both signals increased with the market turmoil to reach high levels of exposure at the end of the month and kept this level during the month of March.

Outlook

- At the end of March, the signals with 3 months', 6 months' and 12 months' time-horizons were indicating a bearish trend in the US, Europe, the UK and in Japan. The turning points were rather far away given the exceptional drawdown of the equity markets in February and March. As a result, the Carry sub-strategy adopted a bearish positioning and suggested to sell only slightly 'in-the-money' calls across all regions.
- The volatility signals on both the US (VIX futures) and Europe (Vstoxx futures) were also indicating a bearish environment. More specifically, the momentum in volatility futures was bullish (hence representing a bear equity regime), the volatility regime was high (reflecting stressed market conditions on a historical basis) and the volatility futures term-structure was steeply in backwardation (typical of stressed markets). As a result, the Risk Management sub-strategy has an important exposure to volatility futures.

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