Q4 2022

UBAM – EMERGING MARKET DEBT 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

- 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 Sovereign external debt delivered a positive return of +8.11% over the quarter according to the JP Morgan EMBI Global Div index. Ecuador (+39.3%), Argentina (+37.6%) and Ethiopia (+26.8%) led the performance. Conversely, Suriname (-11.1%), Zambia (-6.7%) and Ghana (-5.8%) were among the worst performers.
- EM Local bonds outperformed sovereign hard currency indices in Q4 2022, with the J.P. Morgan GBI-EM Global Diversified returning +8.45%. At a country level, the best performance came from Chile (+25.2%), followed by Hungary (+21.3%) and Poland (-16.6%). Worst performance came from Egypt (-20.6%) and Dominican Republic (-3.5%).
- 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.

Sources: UBP, Bloomberg Finance LP, JP Morgan

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

- The fund returned +3.49% net of fees and the attribution report shows + 3.94% in Q4. The main contributor to positive performance was our credit selection (Carry Spread + Spread effect). Our duration effect and curve positioning also contributed positively.
- In terms of instrument types, the main contributor to performance was our sovereign holdings with +4.40% followed by our corporate holdings with +2.27%.
- In terms of countries, our holdings in Colombia, Chile and Mexico contributed the most to performance. On the other hand, China detracted the most.

Portfolio Activity

- In Africa, we mainly initiated exposure to Egypt, Gabon and Kenya on the sovereign side. The exposure to South Africa was slightly increased. Conversely, the exposure to Cote d'Ivoire and Togo were completely sold. Our overall exposure to the region increased on the sovereign side over the quarter.
- In Asia, the exposure to the region decreased overall. The exposure to several countries was decreased on the corporate side, especially in China (TMT, Real Estate and Industrials) but also in India (Industrial, Oil & Gas, TMT) or Malaysia (Consumer and Transport).
- In Emerging Europe, we continues increasing our exposure to Romania on the sovereign side and initiated an exposure to Hungary, consequently increasing our overall exposure in the region.
- In Latin America, we reduced our exposure to Colombia (Oil & Gas, TMT, Utilities) and Chile (TMT and sovereign). Conversely, we increased exposure to Mexico (sovereign, Real Estate, Financials) and initiated exposure to Costa Rica on the sovereign side.
- In the Middle East, we completely sold our exposure to Jordan, UAE and Qatar while we initiated exposure to Oman on the sovereign side.
- We decreased our duration, moving the modified duration of the portfolio from 4.5 years as at the end of September 2022 to 3.4 years at the end of December 2022.
- Our main bets on the EMFX side towards the end of quarter were a long Romanian leu position against the EU (7%) and short Mexikanischer Peso (-4.2%) and Yuan (-5.2%) positions. The net EMFX position as of 30.12.2022 was +3%.

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.
- Our largest country exposures is now Mexico, Romania and Brazil. We are planning to increase our exposure to Brazil as well. Overall LATAM should continue to benefit from the relatively high commodity prices.

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