UBAM – GLOBAL TECH 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 (including the Tech sector), 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.
- Global equities ended the quarter up 7.9% (MSCI World). In the US specifically, the S&P 500 index progressed by 8.6% q/q with a noticeable outperformance of the Growth segment over the Value (11.9% q/q for the S&P Growth Index, +7% above the S&P Value Index). Likewise, the S&P 500 Information Technology Index progressed by 11.6% q/q, +3% above the broad S&P 500 index.
- After a bumpy start into Q2, convertible bonds regained ground in the second half of the quarter, buoyed by the rebound in growth stocks and a relative slowdown in the new issuance pace compared to Q1 record levels. The Refinitiv Global Convertible Bond Index (USD hedged) added 3.6% in Q2, driven by the Communication and Information Technology buckets.
- 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, bringing year-to-date total volume in the region to $55.9bn, out of which 23% comes from Tech companies (mainly issued in Q1).

Performance Review

- For the quarter ended 30 June 2021, the UBAM – Global Tech Convertible Bond Fund (IC USD) returned 5.22%, in line with its investment universe (5.65% for the ICE BofA US Tech Convertible Bond index USD[1]) though exhibiting lower volatility and drawdown.
- The second quarter was marked by two very distinct phases for convertible bonds:
  - In the first half of the quarter, relative to the broader equity market, convertible bonds remained held back by the cyclical rotation.
  - Starting mid-May, volatility in long-term rates helped the Growth side of the market to reverse the trend, which proved beneficial for convertible bonds overall, and especially the Tech segment. From May 12 to June 30, the UBAM – Global Tech Convertible Bond captured 75% of US tech stocks' performance and outperformed the broad US tech market by 5%.
- At firm level, top contributors for the strategy over the quarter were Cloudflare (software & services), MongoDB (software & services) and Nuance Communications (software & services). On the opposite end, holdings in Lumentum (tech hardware & equipment), On Semiconductor (semiconductors) and Cree Inc. (semiconductors) detracted.

[1]For indicative purpose only, the strategy has no official benchmark. [2]Tech Select Sector Index (USD).

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

- Within the UBAM – Global Tech Convertible Bond portfolio, the second quarter was marked by
  - (1) **the trimming of existing positions**, either M&A-driven (Nuance, RealPage, Inphi, Pluralsight) or to strengthen the convexity profile of the portfolio (J2 Global 2029, Verint System 2021, NortonLifeLock 2021-2022).
  - (2) **our process-related focus on:**
    - liquidity: gradual trimming of convertible bonds with unfavorable or poorer liquidity dynamic; selling of Viavi Solutions, GDS, Intertechnology, Vishay.
    - accounting quality: selling of Fastly and Alteryx.
    - credit: underweight exposure to Microstrategy and 21Vianet.
  - (3) **Limited risk-taking** on sector outliers (Square, Palo Alto, Coupa Software).

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 – and tech convertible bonds as well – 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 to the Tech's growth story, whilst dialling back their risk a bit.**
- Convertible bonds' appeal is equally strong in a context of 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.
- The cyclical rotation that has dominated market since the end of last year does not question the long-term case for the tech industry. If anything, the pandemic has accelerated the spread of trends that were already in place before the covid-19 outbreak and for which the long-term fundamentals remain unchanged – if not strengthened (cloud, cybersecurity, artificial intelligence…). **Growth opportunities abound for tech companies that execute on all forms of digital transformations.**
- Though somehow damaging in the very short term, the weaknesses of the tech segment in the first half of the year (till mid-May) have opened an **attractive entry point into the tech convertible bond space**, with more attractive valuations than entering 2021.
- Over the past year and a half, **convertible bonds' issuance dynamism has sparked a broad deepening and renewal of the investment pool, with the tech industry as spearhead.** This opens massive opportunities – including but not limited to greater liquidity and diversification opportunities, with the arrival of new tech companies into our universe next to repeat and well-known issuers.
- The "normalisation" we had anticipated at the end of March, and which started to materialise in May/June should continue into the 3rd quarter. We stick to our target to reduce the volatility of tech equities (by up to 25% over the long run), with an observed beta of around 0.5.

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