UBAM – EM INVESTMENT GRADE CORPORATE 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

- 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.
- In the EM Corporate IG space, at a regional level, Latin America (+7.0%) fared better than others, followed by Africa (+6.2%) while Asia (+2.1%) and the Middle East (+2.0%) were among the laggards.
- At a country level, the best performance came from South Africa (+9.9%), Brazil (+8.7%) and Chile (+8.4%). The worst performance was delivered by Philippines (+0.4%), South Korea (+0.5%), Hong Kong (+0.7%) and Jordan (+0.8%).
- At a sector level, the best performance came from Pulp & Paper (+14.9%) and Metals & Mining (+10.0%). Diversified sector performed the worst returning +0.8%.

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

- Over the quarter, the fund returned +2.34% net of fees, vs. +3.05% for the JP Morgan CEMBI Diversified High Grade Index.
- Performance attribution data shows that the fund underperformed its benchmark by -45bps in Q4 2022 (gross of fees).
- In relative terms, the underperformance came from the fund's duration positioning as well as the credit selection (carry spread and spread effect) detracting -41bps and -16 bps respectively. Our curve positioning, however, had a positive effect with +13bps.
- Main contributors to relative performance, excluding the effect of our interest rate duration/curve positioning which is managed at portfolio level:
  - Country-wise, negative contribution came from our selection in China and Singapore. Our selection in Mexico also detracted to performance. On the positive side, our credit selection in the Philippines, Korea and Saudi Arabia contributed the most.
  - Sector-wise, our credit selection in Industrials detracted to relative performance while our credit selection in Quasi Sovereign, Utilities and Financials was beneficial.

Portfolio Activity

- Over the quarter, we reduced our exposure to Asia ex Japan and the exposure to Emerging Europe was completely exited. On the other, hand the exposure to Latin America was increased.
- In Asia, we reduced our exposure to China across several sectors, namely Financials, Industrials, Real Estate and TMT.
- In Emerging Europe, the exposure to the Oil & Gas sector in Kazakhstan was sold.
- In Latin America, Brazil exposure increased during the quarter.
- At sector level, we reduced exposure to Real Estate (mainly in Chin, Honk Kong and the Philippines), in Oil & Gas and in Financials across several countries.
- 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.

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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 Indonesia and India. Our largest underweights are in China and Singapore.
- At a sector level, our largest overweight positions are in TMT and Transport. Our largest underweight exposures are in the Financials and Metals & Mining sectors.

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