UBAM - EM SUSTAINABLE SOVEREIGN 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 increased significantly over the quarter; 2-year US Treasuries were up 160bps to 2.33%, while 10-year US Treasuries rose by 83bps to 2.34% as the Fed delivered its first hike and the market priced more than 200bps of hikes until the end of the year.
- In terms of the risk environment, we downgraded our short-term expectations in Q1 2022, given Russia's invasion in Ukraine affecting the global supply chain, which was slowly recovering from the pandemic.
- Fears of rising interest rates kept investors away from fixed income in general over last quarter. The asset class saw outflows at -$14.1bn, according to data from JP Morgan. This follows up from weak flows of +$0.3bn in Q4 2021. In 2021, EM Fixed Income funds saw an inflow of $52.5bn.
- EM Sovereign external debt delivered negative returns at -10.0% over the quarter according to the JP Morgan EMBI Global Div index. Venezuela (+56.60%) and Lebanon (+16.22%) led the performance. Russia and Belarus were removed from the index, excluding these, Ukraine (-51.36%), due to the war, Pakistan (-18.67%) and Kazakhstan (-15.20%), due to political instabilities, were among the worst performers.
- At a regional level, the worst performance came from Emerging Europe (-31.61%). Africa and the Middle East returned -4.08% and -4.09% respectively over Q1 2022.

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 -7.94% net of fees, compared to -10.02% for the JP Morgan EMBI Global Diversified Index. Gross of fees, UBAM - EM Sustainable Sovereign Bond returned -7.75%, outperforming its index by 227bps.
- The quarter saw both higher rates and wider spreads. The fund benefitted from partially hedged duration positoin, and from positive credit selection. Additionally the fund was short Rubles.
- Main contributors to relative performance in Q1 2022 were:
  - Underweight in Russia (+227bps), overweight in Gabon (+23bps) and overweight in Egypt (+20bps).
- Main detractors to relative performance in Q1 2022 were:
  - A property developer we owned in China (-100bps) and overweight in Ukraine (-66bps). Having zero exposure to Turkey (-34bps) and Bahrain (-26bps) also detracted from relative performance.

Portfolio Activity

- Over the quarter, our scorecard fell into in the “conservative” territory, with March marking the lowest score in the last twelve months in the view of deteriorating risk environment, although EM fundamentals moved into positive territory.
- In Africa, we reduced our exposure to Egypt local bonds, together with Angola (sovereign). We have also added exposure to Gabon and Ghana.
- In Emerging Europe, we sold our exposure to Russia completely, ahead of the invasion. We have also reduced our holdings in Kazakhstan earlier in the quarter.
- In Latin America, we increased our exposure to Chile, Colombia, and the Dominican Republic at the cost of Guatemala and Paraguay. We exited our position in Costa Rica over Q1 2022.
- Conversely, we increased our positions in Oman but sold all of our holdings in UAE.
- Our investments in Supranational issuers in local currency bonds denominated in GEL, KZT and INR remained – such securities typically finance development projects in those countries.
- The fund achieved an MSCI ESG Quality Score of 4.61, outperforming the standard market index (JP Morgan EMBI Global Diversified), which returned an ESG Quality Score of 3.14.

Outlook

- Inflation has risen to elevated levels globally and has impacted interest rates world-wide. Many EM Central banks have hiked early, starting a tightening cycle as soon as early 2021 in some cases. DM Central banks first read this inflation as transitory and have been reassessing their outlook. They now seem set for a quicker tightening of their interest rates.
- US rates have sold off significantly in Q1 2022 and remain a risk to be watched carefully going forward. The curve is now pricing a significant amount of tightening by end of 2022 (about 2.5% in rate hikes according to Fed Fund futures).
- The front end of US curve (up to 2 years) is now very steep, and yields start to be compelling in the asset class. We wouldn’t expect a strong rally back in rates or spreads in the short term, but the increased carry should start to do its work in helping the asset class performance.
- In Q1 2022, about USD 15bln exited the asset class (mainly retail money). Despite the negative Q1 performance, but on the back of higher yields, we would expect investors to get attracted back in the asset class.
- The current yield pick-up that can be found in EM Sovereign bonds, when compared with other spread assets, is significant. Particularly in the HY segment, spreads to US high yield are at historically wide levels. At the index level, yields at end of March were 6.47% for the asset class, for 7.6 years of duration.
- Within EM sovereign debt, we continue to favour high yield bonds, which offer attractive carry. They also present a lower duration than investment grade bonds along with more spread cushion, thus insulating them from potential further rises in US rates.

- The fund remains predominantly positioned in Hard Currency Debt (98%), with selective positioning in supranational instruments in local currency markets such as Kazakhstan, and India, though we have the FX risk hedged.
- At a country level, our largest positions are in Indonesia (6.45%), Oman (6.42%) and Uruguay (5.44%). In terms of overweight relative to the universe, our largest active positions are also in Uruguay (+3.1%), and Oman (3.27%), as well as Benin (2.72%) and Cote d’Ivoire (2.61%).
- In contrast, our largest underweights are typically in countries that form large part of the benchmark, but that we do not hold, mostly for ESG related reasons. For instance, we count no exposure in Saudi Arabia (4.16% of the index) and Turkey (3.96% of the index).

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