

U ACCESS – CHINA 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

- During the last quarter of 2022, after social tensions through November, many lockdowns have been lifted and gradual reopening process started. Beijing announced that it was pivoting away from “Zero-Covid” in December. This has been the main catalyst for Chinese assets which rallied significantly. Markets focusing on the prospect of reopening were not impacted by the mixed economic data releases during the quarter. It is expected that the recent slowdown was primarily due to the restrictions in place at the time.
- For the quarter ending 27 December 2022, China’s domestic stock market (hereafter the “A-share market”) rose by 1.1% (CSI 800 Total Return Index). For purpose of comparison, over the same period, Hong-Kong-listed mainland securities (the Hang Seng Index, HSML100) was up 8.6% (CNY, total return).
- Over the past three months, the top 3 performing sectors of the A-share market were Social services (+22.15%), Health Care (+13.60%), and Computer (+10.16%). At the bottom-end, Utilities (-6.49%), Nonferrous Metal (-7.51%) and Defense (-7.88%) reported the most negative returns q/q (based on ShenYin WanGuo classification).
- During the quarter, convertible bond issuance in domestic China totalled CNY 22 billion through 19 new convertible issues. This brings the total of issuance for 2022 to 122 convertible bonds and CNY 198 billion. At December-end, they are 460 convertible bonds in the Chinese onshore market, for a total outstanding amount of CNY 972 billion. Sector wise, the financial sector (banks and non-banks) still represents the largest share of the region convertible universe.

Performance Review

- In Q4, the strategy decreased by -2.7% (U Access – China Convertible Bond IC CNH), outperforming its investment universe¹ by 0.5%. Such outperformance is explained by sector allocation and the bond selection. Sector-wise, the alpha of the strategy in Q4 came primarily from its investments in Light Industry Manufacturing, Construction & Decoration and Nonferrous Metals. On the opposite-end, Banks, Base Chemicals and Machinery Equipment had negative impacts.
- The Chinese equity market rebound during the last two months of the year, bringing the quarterly performance to +1.1%. However, 2022 has a very difficult year with an annual return of -19.8% for the Chinese A-share market. In this context, the on-shore convertible bond market (CSI Convertible Bond Index) exhibited downside risk mitigation as it fell only -8.8% in 2022.
- During this very particular year, the strategy decreased by 9.5% after fees, -0.7% behind of its investment universe and +9.5% ahead of the equity A-share market (CSI 800 TR).

Portfolio Activity

The investment level of the U Access – China Convertible Bond portfolio remained above 95% for the whole period under review. In comparison to the investment universe, we maintained an underweight exposure to the Financial sector in accordance with our systematic approach which aims to ensure sufficient portfolio diversification. For purpose of indication, the portfolio’s exposure level to the Financial sector was slightly below 20%, compared to an average weight of 39% for the universe. Likewise, the cumulative weight of the portfolio’s top 10 holdings remained below 13% (vs. 32% for the investment universe).

- In terms of risk profile, throughout the quarter, the portfolio maintained greater allocation to both the “balanced” and “higher equity sensitivity” segments than the investment universe, and an underweight positioning to the “bond-like” segment.
- At December-end, the portfolio exhibits an average equity sensitivity of 63.2% and a credit spread of 123bps.

Outlook

- As the Chinese government announced that it was pivoting away from “Zero-Covid” in December we expect an improvement of economic activity. We expect better-than-expected economic data release could further fuel the rally in Chinese assets, as it will reduce concerns about weaker activity in Q1-23. We then see a consumption-led recovery that should take hold from Q2-23 onwards. For 2023 we continue to hold a GDP forecast at 5.2%, above current consensus. The Chinese on-shore convertible bonds market being made up of smaller companies at an early stage of their growth cycle, with strong earnings growth potential in the mid-to-long term and less correlation to the overall slowing global growth environment but more driven by the Chinese domestic growth they should benefit strongly from the economic recovery.
- A-share market price, measured using the CSI 800 index as at the 31st December 2022, has fallen by 19.8% over the year. Consequently, equities are now trading at a 5Yr Cyclically Adjusted Price-to-Earnings ratio of 9.4x (vs. 12.5x for the US S&P 500 index). To our view this could represent an attractive entry point for long term investors. However, the high volatility associated with A-shares has historically been a drawback when considering exposure to onshore China. Thanks to their dual nature, convertible bonds give investors access to A-shares with lower volatility and reduced drawdown risk.
- The Chinese onshore convertible bond market offers access to companies and sectors with a direct or indirect exposure to the growing Chinese consumer’s demand. In our view, these constitute a fertile hunting ground as China moves to its era of “common prosperity”.
- Our U Access – China Convertible Bond strategy follows a systematic selection & allocation approach. The latter has been designed to provide investors with a liquidity-enhanced and diversified exposure to China’s on-shore convertible bond market, which is capable of navigating the A-share market’s bouts of volatility, as evidenced by the outperformance achieved by the strategy since its inception compared with both the equity market and the convertible bond universe.

¹ Investment universe = internal indicator corresponding to all outstanding Chinese onshore convertible bonds eligible to the strategy’s investment criteria, weighted by their outstanding size. For indicative purpose only, the strategy has no official benchmark.

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