THE DRIVE YOU DEMAND

U ACCESS (IRL) TREND MACRO

Quarterly Comment | Q4 2018

For Qualified Investors in Switzerland or Professional Investors or Eligible Counterparties as defined by the relevant laws.

Markets

- Global equity markets were down -13.42% during the fourth quarter, bringing the YTD performance to -8.71%, as measured by the MSCI Daily TR Net World Index. The final quarter of 2018 was not good for equity markets. Investors had to contend with rising US central bank interest rates, a sharp slowdown in Eurozone business confidence, weaker Chinese growth and rising geopolitical concerns (including Brexit, Italian politics and the ongoing trade conflict between the US and China). This all proved an indigestible cocktail for investors. The biggest challenge for markets is that global growth is slowing at the same time as the Central Banks are winding down quantitative easing.
- In contrast to the first three quarters of 2018, Developed Markets underperformed global markets in Q4. In the US, markets were dominated by fears of further rate hikes and that the US is late in its economic cycle, driving the S&P 500 down by -13.97%. The MSCI Europe declined by -11.32% over the quarter, with all underlying county indices being down meaningfully. The Nikkei 225 also saw a strong decline (-17.02%).
- Emerging market (EM) equities also declined meaningfully in Q4 but did relatively better than Developed markets, the MSCI EM being down -7.47% in Q4. The prospects of a Chinese stimulus and a slower pace of interest rates hikes in the US, as well as lower equity valuations were supportive factors. On a YTD basis, Emerging Markets still underperformed Developed markets, on aggregate, with the MSCI Emerging Markets being down -14.58% in 2018.
- In light of market sell-off, volatility increased sharply during this fourth quarter, closing the year much higher than in 2017. The regime change that we started to witness in February continues to be valid, as markets seem more focused on fears like slower growth, trade tensions or higher interest rates. The VIX closed Q4 at around 25, versus close to 12 at the end of Q3.
- After rising during most of 2018, US and European bond yields decreased in Q4. After initially moving higher in the first part of the quarter, yields sharply reversed from mid-November, as increased geopolitical tensions and question marks about the strength of the global economy drove equities lower, with investors selling equities and buying treasuries, in a classic risk-off trade. Monetary policy continues to tighten, although the Fed has lately been more dovish than during most of the year.
- In light of policy shifts progressing in the major economies, the transformation of investors' fixed income exposures across alternative strategies has now become a reality. U Access (IRL) Trend Macro offers access to diversifying risk drivers and exposures by seizing long and short investment opportunities across mainly interest rates, credit and currencies. It has historically shown a limited correlation to traditional assets.

Performance Review

- U Access (IRL) Trend Macro gave up -3.63% (Class B USD, net to investors) during Q4. The Fund ended the year a negative -8.40% net of fees. The HFRU Macro index ended the year at -5.82%
- The decline in performance in the fourth quarter was driven primarily by losses in the Fund's short positioning focused on developments in Italy and secondarily by the continued sell-off in emerging markets credit. After releasing a first budget in September, with a deficit that was in breach of the European Commission's (EC) stability and growth pact, the italian government submitted a second budget in December. Despite the fact that it was still in breach and being unrealistic, the EC surprisingly judged that enough progress had been made to a procedure and bonds rallied as a result. The situation is still on-going and the investment team expects more developments in 2019. In Emerging Markets, Argentina credit sold off sharply in December in thin markets, even though underlying economic and political news flow was actually quite encouraging. Ukrainian credit spreads also widened in Q4.
- In terms of contribution by asset class, credit was the largest performance detractor with -150bps of negative contribution, mainly attributable to Emerging Markets, particularly in Argentina where credit spreads widened sharply. The investment team increased exposure during the sell-off, as it believes the USD-denominated debt remains compellingly attractive. Given the minimal financing needs for this country for 2019 and most of 2020, the team believes credit has substantial potential to rally, as the market begins to recognise the improvements in the economy. Ukrainian credit was also a slight negative contributor in Q4.
- Elsewhere, the interest rates book produced a negative contribution of -130bps. Shorts on Italian bonds were the largest detractor, followed by short US rates positions, as the investment team incorrectly gauged the market reaction following the Trump-Xi talks in Buenos Aires. Mexican steepeners were a small detractor On the positive column, long T-Bill positions in Egypt, Ghana and Nigeria continued to be additive to performance. Another positive contributor was the Fund's long-standing Chinese rates positions.
- The currencies book was routhly flat over the quarter. Gains on the ARS were offset by losses coming from shorts on the ZAR and the BRL.

Portfolio Activity

- The main portfolio activity during the quarter was related to the Italian theme. As mentioned above, the portfolio has been positioned short Italian bonds (mainly played through being short 10Y BTP futures) to reflect the investment team's concerns on the country's budget deficit. Significant gains were made out of this position at the end of September and early October in light of the initial budget deficit target figure released at the time (i.e. 2.4% p.a. for the next three years), which was negatively received by the market. However, on December 19th, the EC finally accepted the Italian government's 2019 deficit projection of 2.04% and decided not to proceed with the Excessive Deficit Procedure (EDP). The investment team believes the deficit reduction from 2.4% to 2.04% seems incorrect. As a matter of fact, the team's considered opinion was that the EDP would give the rating agencies cover to lower Italy's credit rating and cause Italian bonds to sell off, as they had done back in September, when Italy's budget was initially submitted to the EC. The team thinks this is a political decision the EC will come to rue. Although the investment team believes that the fundamentals for Italian bonds shall remain negative in 2019, it decided, from a tactical perspective, to eliminate its short position on Italian bonds and await a catalysing event to re-enter the position.

- Argentina remained another important story for the Fund this year. We discussed the negative performance contributions in previous letters. Over the second half of 2018, credit started to sell off sharply, as the market began pricing in a near-term default risk and growing concerns of the country's inability to rollover the stock of short-term debt. The investment team started to accumulate sovereign and provincial credit on a hedged basis, as it believed the market concerns were overblown. In Q4, the team continued to increase exposure and bought into the sell-off. By year-end, Argentina credit represented the largest single exposure in the portfolio. The manager believes this represents one of the most exciting opportunities in the portfolio in 2019.

Outlook & Positioning

- The investment team's global outlook underlines several challenges. The main challenge for markets is that global growth is slowing at the same time as the Central Banks are winding down quantitative easing. Central Banks are trying to wean the markets off tools like asset purchases and QE used after 2008 and rely more on traditional tools like interest rates. The team expects the Fed to reduce their balance sheet further in 2019 and in 2020. Likewise, the ECB has ended QE, even though the European economy is not completely out of the woods. Even though China has begun a process of monetary and fiscal easing, the team does not expect it to be anywhere close to the levels seen in 2009. Investors expecting more will be disappointed. In this slowing growth environment, with fears of a US recession ahead, markets should remain fickle. However, in the near-term, a recession seems unlikely. But neither is an acceleration of growth. It is because of the slowing growth environment that US-China trade war, a hard Brexit and Italy all pose such risks to markets, as they could accelerate a modest slowdown into a sharper downturn.

- The biggest question for the markets is the US-China trade war because of its implications for global growth. The Trump administration is more responsive to market pressures, while the Chinese are more responsive to economic growth. The US administration has three main objectives in the trade negociations: a) reducing the trade surplus by $200bn by 2020 and the reduction of tariffs in non-critical sectors to US levels, b) stopping Intellectual Property (IP) theft, forced technology transfers and restrictions on foreign investment by revising the "negative list", and c) getting China to end subsidies for SOEs. The investment team's belief is that an agreement on the the first two points above is possible, but cannot be reached in three months. The third point is, according to the team, a non-starter for the Chinese administration. This deal is a lot more complicated than the USMCA (new NAFTA), which took a full year to negociate. However, an expression of progress should be seen by late-February by the US agreeing not to increase tariffs.

- While Emerging Markets have broadly sold off, there continues to be a number of countries where idiosyncratic risks persist. The team believes that a pause by the Fed is supportive of EM carry in both credit and FX. Slowing global growth, quantitative tightening and geopolitical tensions are not helpful for EM equities. However, valuations are supportive. Idiosyncratic risk in countries like Mexico (aggressive fiscal plans), India (elections), Brazil (Bolsonaro's ability to cut pension spending), and Turkey (re-capitalisation of the banking system) means country selection is critical.

- In the investment team's opinion, the most attractive strategy in this environment is short-dated EM dollar debt. It is not exposed to FX devaluation and rate hikes do minimal damage due to carry and roll down. The team has assembled what it believes is a compelling portfolio of high-yielding assets with relatively modest duration. This includes a sizeable exposure in Argentinian USD credit across sovereign, quasi-sovereign, provinces and select corporate bonds with relatively low duration and double digit yields. The team continues to like the local currencies of Nigeria, Egypt and Ghana. These economies are decoupled from the broad markets and substantial amount of portfolio inflows. The two EM countries where the team remains most concerned are Turkey and Mexico; the portfolio is then short Turkey's credit and has curve steepeners in Mexico.
- The quarter ended with a VaR of 23bps; it averaged 69bps over the quarter and 77bps over the year. In recent months, the daily volatility of markets has reached levels that are almost un-investable. This volatility is primarily driven by uncertainty surrounding the US China trade talks. And that makes sense, given that these two countries dominate the global economy. Tariffs would subtract a sizeable chunk of growth for both countries. Till we see this volatility subside, it is the investment team's intention to eschew from sizeable beta-trades.