UBAM – EMERGING MARKET DEBT OPPORTUNITIES

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 excluded from the index, excluding these, Ukraine (-51.36%), Pakistan (-18.67%) and Kazakhstan (-15.20%) were among the worst performers due to political instabilities.
- EM local bonds performed better than hard currency indices in Q1 2022, with the J.P. Morgan GBI-EM Global Diversified returning -6.5%. At a country level, the worst performance came from Egypt* (-11.18%), where the central bank loosened its peg to the US Dollar.
- EM Corporate bonds delivered returns of -9.3% 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 -9.9%, while their High Yield counterparties returned -8.5%, outperforming the broader index. Spreads over US Treasuries widened by 17bps to 318bps in Q1 2022.

**excluding Russia*

Performance Review

- The fund returned -7.59% net of fees over the quarter. Spread widening was the main cause for the underperformance, with duration also detracting marginally from performance.
- In terms of asset allocation, our allocation to Sovereign and Local bonds contributed the best. Conversely, our allocation to Hard Currency Corporate and Quasi Sovereign bonds was the biggest detractor to performance of Q1 2022.
- In terms of country allocation, our best performance came from Russia (zero holdings in in sovereign bonds), Brazil (Corporate and Local exposure) and Colombia (Sovereign/Corporate exposure). Conversely, our allocation to Chinese Corporate issuers were the biggest detractors to performance over Q1 2022.

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 increased our exposure to TMT in South Africa. We sold a part of the sovereign holdings across the region (Senegal, Kenya).
- In Asia, we added our exposure to India, predominantly in the Oil & Gas sector. We sold holdings in Chinese Consumer, TMT and Real Estate companies, decreasing our exposure to the country. We slightly increased our Malaysian exposure by participating in a new issue in the Transport sector.
- In Emerging Europe, we sold our exposure in Russia and Kazakhstan, with substantially reducing our holdings in Ukraine.
- In Latin America, we added some local currency bond exposure in Brazil, Colombia, and Mexico, after a strong hiking cycle in 2021 led to strong improvement in valuation, while we reduced our exposure to Paraguay and Ecuador. We exited our position in Guatemala over the course of Q1 2022.
- In the Middle East, we reduced our exposure to the UAE.
- Our EM currency exposure was broadly flat at 10%.
- We increased our duration hedge over the course of the quarter as yields rallied, moving the modified duration of the portfolio from 5.3 years as at the end of December 2021 to 2.7 years as at the end of March 2022.

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 in early 2021 already for some of them. DM Central banks first read this inflation as transitory and have been reassessing their outlook and seem now 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 2years) is now very steep, and yields start to be compelling on the asset class. We wouldn't expect in the short term a strong rally back in rates or spreads, 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). Despite the negative Q1 performance, but on the back of higher yields, we would expect investors to get attracted back in the asset class.

- Overall, we continue to favour corporate bonds with shorter maturities and have selective exposure to local currencies.
- We keep a reduced interest rates duration (2.7 as of end of March 2022) by using hedges in interest rates duration via UST futures and we are looking to continue to play these instruments actively in Q2.
- Our largest country exposures are in Colombia (via corporate, sovereign, and local) and Brazil (corporate and local).
- In FX, we are short CEE (via CZK and HUF) and long commodity currencies such as BRL, CLP, COP

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