Q3 2023

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

- After more than 18 months of aggressive interest rate hikes, it appears that they might be coming to an end. Some emerging market central banks are confident enough to have already implemented multiple rate cuts. Major central banks, on the other hand, are still raising rates in the third quarter but are hopeful that they won't need to increase them further. While they recognize the ongoing battle to control inflation, they believe that their current monetary policy is restrictive and might lead to a gradual reduction in inflation.
- Rather than focusing on how much higher interest rates should go, the main concern now is how long they should remain elevated. It's possible that there may be a need for some additional rate hikes, but both CB President Christine Lagarde and Fed Chair Jay Powell suggest that even if rates have peaked, rate cuts might not be on the horizon.
- Some countries are already experiencing or at the brink of recession, and the global economic slowdown is becoming more evident. The United States has shown positive growth surprises. Mainland China's economy had been disappointing until recent signs of stability in various sectors, and the renewed rise in oil prices due to supply factors and spikes in food prices in countries like India highlight the era of higher inflation volatility, where changes in key commodity prices are influenced by supply as much as changes in demand.
- Elevated oil prices briefly halted the decline in overall inflation, but at the core level, prices of non-volatile goods have been steadily decreasing. A notable rebound in oil prices during the three months up to September, coupled with a surge in food prices in Emerging Asian markets, disrupted the overall disinflation trend in Emerging Markets, excluding China and Turkey.
- On the other hand, core inflation has been on a downward trajectory, and the most recent data is well within the target ranges set by central banks in many Emerging Markets. The exceptions are Poland, Romania, Colombia, and Mexico, where core inflation remains a concern. The worry is that a significant portion of this deceleration in core inflation is attributed to a sharp decline in the prices of goods, and this trend could reverse if weaker currencies drive up import prices.
- EM Government bonds index exhibited a negative total return of -2.23% (JPM EMBI Global Diversified) and EM Local Currency Government bonds index showed a -3.26% total return (JPM GBI-EM Global Diversified) in the 3rd quarter.

- EM investment grade corporate bonds index showed a negative total return of -1.33% (JPM CEMBI BD) due to the increase in US Treasuries' rates, while spreads tightened.
- According to data and JP Morgan research forecast, Emerging Markets bond flows have seen an decrease of $2.7bn since the beginning or the year. High yielding real rates keep being supportive to the asset class.

Sources: UBP, Bloomberg Finance LP, JP Morgan.

Performance Review

- The fund performance was -0.75% gross of fees vs. -1.33% for its benchmark JP Morgan CEMBI Diversified Investment Grade.
- The fund outperformed its index by 0.37%.
- The performance mainly came from duration positioning and issuer selection.
- In terms of credit selection, at a country level, the biggest performance contributors were Slovenia, South Arabia, India and Czech Republic, but impaired the positive effect by the allocation in China, Singapore and Qatar.
- At a sector level, the positive performance came mostly from issuer/issue selection in Industrials and Financials.

Portfolio Activity

- Over the quarter, we increased our exposure to EM Europe, while reduced in Middle East and Africa.
- In EM Europe, positions were increased in Poland and Hungary (Oil & gas, Sovereign respectively).
- In Middle East, Saudi Arabia and U.A.E exposure were reduced (various sectors).
- In Asia ex Japan, some changes in countries and sectors. Philippines (Sovereign), Taiwan (Industrials), India and Hong Kong (various sectors).
- In Latin America, overall exposure remain unchanged, with some variations in the country and sectors allocation. Reduced Mexico and Brazil (various sectors), but increased Chile (Consumer, Pulp & Paper).

Outlook

- We continue being of the view that we are at the end of FED’s hiking cycle, and the main part of US base rates adjustment is behind us. Inflation is trending lower, but the speed of adjustment is slow as core inflation remains sticky and stubborn. We believe that technicals could be for some time more challenging for the longer end of US yield curve as the US Treasury is increasing its issuance, that is why we tactically moved to an underweight position in terms of duration.
- Emerging markets appear to be in a stronger position than in the past, with improved growth prospects. However, it's important to note that a slowdown in China could have varying impacts on different countries, considering their fiscal strength.
- We hold a positive outlook, as we believe that any reduction in Chinese growth is being balanced by more optimistic forecasts for Latin America and other Asia countries. Nevertheless, we are closely monitoring concerns related to rates in developed markets and the strength of the US dollar, as these factors could influence returns.
- Although EM fundamentals remain strong and supportive, spreads have begun widening on slightly tight valuations.
- It is worth reiterating that EM IG companies on an aggregate level are in a very healthy credit position in general, having deleveraged in past years and having extended their debt maturities at lower interest rates taking advantage of the low interest cycle prior to the quantitative tightening cycle, so they stand on solid foot to weather a challenging period.

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