THE DRIVE YOU DEMAND

UBAM - GLOBAL CARRY

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 valuation 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 the market sell-off, volatility increased sharply during this fourth quarter as markets sell off and closed 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 the fourth quarter 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. Strategies like UBAM - Global Carry provide a risk/return profile similar to fixed income but with a very different source of returns, decorrelation, and by investing in listed, highly liquid instruments.

Performance Review

- Over the fourth quarter, UBAM - Global Carry returned -2.72% net to investors, underperforming its ML FED Funds Effective Rate.
- On a monthly basis, the performance generation was disparate (-2.09% in October, +0.37% in November and -1.00% in December), due to an environment of severe equity drawdown, with a pause in the middle of the period, across the different regions. In addition, the amplitude of the move was quite similar across regions, with Japan being the worst performer (-17.02% for the Nikkei 225), followed by the US (-13.97% for S&P500), Europe (-11.32% for the MSCI Europe) and the UK (-10.41% for FTSE100 index).
- The Carry strategy – also called “delta-hedged Call selling” – contributed -314bps (gross) during Q3. Return generation was led by its US component (-252bps). Despite strongly negative markets, trend indicators were unclear until early December, and the level of volatility priced in the options market remained low. This negatively impacted the strategy as the level of premia collected didn’t compensate for the severity of market movements. The same happened to the Japanese component, which suffered from the lag in its defensive positioning compared to market movements. It dragged -57bps over the quarter as the move down was very sharp and came on the back of a strong rally in September. On the other hand, European and UK allocations were relatively resilient in this adverse environment, providing some diversification to the global carry strategy. In fact, the European component was quasi flat over the period (-1 bps), as was the UK component (-3 bps), with the latter being even positive in December. This was mainly achieved thanks to a more defensive positioning in those two regions, helping to protect the strategy in the higher volatility regime.
- The Risk management strategy – also called “delta-hedged Tail Risk” – added +12 bps (gross). In terms of regional splits, the US component added +7 bps and the European exposure added +5 bps. This year has been marked by the shift in volatility from the US to Europe with the VIX moving higher than the Vstoxx and witnessing some lower cost of carry. In addition, the Vstoxx was quite difficult to trade, with sharp rallies followed by sharp declines, not allowing the signals to adapt correctly. Nevertheless, Q4 was positive, mainly thanks to the sharp move up in volatility, both in the US and in Europe. This compensated for the adverse effect that volatility moves had on our bullish positioning in October and on our bearish positioning in November.
- Finally, +54bps of gross contribution were generated by the T-Bills book, where most of the cash holdings were invested for optimisation and UCITS diversification restrictions.

Portfolio Activity

- Within the Carry strategy, which represents 90% of the portfolio allocation, there was some dispersion in terms of market trends at the beginning of the quarter that converged as the year came to a close. European and UK signals where already in a defensive mode, so investments were mainly done in 60-delta calls along the quarter. On the other hand, US and Japan equity markets trends were still bullish, leading these two sub-strategies to be positioned too aggressively until the end of November. They finally converged towards the European and UK sub-strategy positioning’s in December, allowing the overall portfolio to be more defensive.
- Within the Risk Management strategy, which represents the remaining 10% of the portfolio allocation, US and Europe sub-strategies evolved in the same way. In fact, the exposure to volatility futures was minimal on both US and European volatility futures at the beginning of the quarter but rose rapidly to a

high level by mid-October, due to the rapid sell-off in equities and the pick-up in volatilities. Signals remained rather stable in November, allowing the sub-strategies to be well positioned in December and to benefit from the sharp rise in global volatilities.

Outlook & Positioning

- At the end of December, the signals with 3 months', 6 months' and 12 months' time-horizons were indicating a strongly bearish trend in all regions (US, Europe, UK and Japan) and the turning points where quite far except for US short term trend indicator. As a result, the Carry sub-strategy adopted a very defensive positionning and suggested to sell only 60-delta calls across regions.
- The volatility signals on both the US (VIX) and Europe (Vstoxx) were also indicating a bearish/stressed environment. More specifically, the momentum in volatility futures was bull (hence representing a bear equity regime), the volatility regime was high (reflecting stressed market conditions on a historical basis) and the volatility futures term-structure was in backwardation (typical of stressed markets). As a result, the Risk Management sub-strategy has an exposure to volatility futures that is above the neutral point.