

UBAM – GLOBAL SUSTAINABLE 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

- Reflationary pressures and the cyclical rotation remained pressing topics in Q2. The higher growth parts of the market, however, regained vigor starting mid-May as the uptrend in the US long-term rates experienced some volatility. Solid M&A dynamism in these fields, along with strong earnings reports, also helped fuel the rebound.
- Eventually, global equities ended the quarter up 7.9% (MSCI World). In the US, the S&P 500 index closed the quarter up 8.5% and the Nasdaq 100 +11.4%. In Europe, the Stoxx Europe 600 progressed by 6.4% q/q. Conversely, the Nikkei 225 ended the quarter down 1.2%.
- After a bumpy start into the year, convertible bonds have been making a comeback since mid-May, buoyed by the rebound in growth stocks and a relative slowdown in the issuance pace compared with Q1's exceptional volumes. The Refinitiv Global Convertible Bond Index (EUR hedged) progressed 3.3% in Q2. Region-wise, the global convertible bond market was led higher by the US, Europe and Asia while Japanese convertible bonds closed the quarter in negative territory.
- Global convertible bond issuance was strong in the quarter: ICE BofA reported \$39.6 billion in new convertibles. The US market topped the list with \$15.3bn, closely followed by Asia (\$15.0bn). Europe saw \$8.6bn in volume. Japan issued \$0.7bn. Year-to-date, \$98.9bn has been priced globally (\$55.9bn from the US, \$22.2 from Asia, \$18.9bn from Europe and \$1.9bn from Japan) – an all-time high.

Performance Review

- For the quarter ended 30 June 2021, the UBAM – Global Sustainable Convertible Bond Fund (IC EUR) returned 2.41%, slightly below the Refinitiv Global Convertible Bond Index at 3.31%. The fund outperformed the Bloomberg Barclays Global Aggregate Corporate EUR-Hedged Index (2.25%). Relative to the broader equity market, convertible bonds remained held back by the cyclical rotation in the first half of the quarter before rebounding strongly starting mid-May, as the rotation trade lost some ground to the growth segment. From May 12 to June 30, the strategy captured almost the full performance of global equities (MSCI World Hedged EUR).
- Unsurprisingly, the equity sensitivity component was by far the main driver to the strategy's performance in Q2. Region-wise, holdings in the European market accounted for most of the performance. Investments in the US also proved beneficial overall, whereas those in Asia and Japan detracted. In relative terms versus the index, the portfolio's average underweight stance within the US hurt performance. Conversely, our average overweight positioning to Europe proved beneficial. In terms of sector, the fund's security selection in Consumer Discretionary, Info Tech, and Real Estate were the main contributors to the strategy's absolute performance whereas Industrials, Utilities and Energy detracted on average.
- Over the period, top contributors in absolute terms include Deutsche Wohnen (+33bps, Europe Real Estate), Snap (+29bps, US Communication) and Shopify (+23bps, US Tech). Top detractors were Southwest Airlines (-27bps, US Industrials), Twilio (-16bps, US Tech) and Win Semiconductors (-14bps, Asia Tech). Relative to the index, our overweight positioning in Deutsche Wohnen (+25bps), Shopify (+20bps) and Kering (+17bps) supported the relative performance, whereas our absence from Sea (-37bps, US Communication) and overweights to Southwest Airlines (-17bps) and Twilio (-16bps) came at a cost.

Portfolio Activity

- At June-end, the average equity sensitivity of UBAM – Global Convertible Bond stands at 52% (-3% q/q), below the global convertible bond market (57% for the Refinitiv Global Convertible Index). The strategy's interest rate sensitivity is low, at 1.7 for a 4-year duration. Lastly, the portfolio's average credit spread stands at 179bps (-35bps q/q) vs. 265bps for the index, reflecting the quality bias inherent to our philosophy.
- Region-wise, the fund is primarily exposed to equity markets through investments in the US (29%). Investments in Europe account for 19% whereas Asian and Japan account for 4%. Relative to the index, the portfolio exhibits an average overweight stance to Europe (+9pts equity sensitivity) and an average underweight positioning to both the US (-10pts) and Asia/Japan (-4pts).
- During the course of the quarter, we took advantage of weaknesses in the convertible bond market (early May) to strengthen some of our "sustainable convictions" in the US, such as Dexcom, Workday and Etsy. Meanwhile, we increased our exposure to Europe which exhibits overall robust credit profile on top of a distinct (and complementary) opportunity set in comparison to the US. This notably includes a large share of consumer discretionary businesses in the region's growth segment, which contrasts with the Tech and Healthcare dominance in the US. Convertible bond primary activity remained sustained in Q2, including from the part of repeat issuers. This allowed us to arbitrage some existing investments towards convertibles with more balanced profiles, increasing the overall convexity metrics of the portfolio.
- At single security level, main buys over the quarter include the Rohm 2024, Asos 2026, the sustainability-linked convertible Edenred 2028 and the Michelin 2023. On the latter, aside from an attractive convexity profile of the convertible bond, we value the efforts made by the company to offer more sustainable products. Michelin has set ambitious targets to achieve 40% sustainable materials in its tires by 2030 and 100% by 2050.

Outlook

- As we prepare for a more mature phase of the economic cycle, risks of accrued volatility and short-term drawdowns should increase. Proactive risk management becomes increasingly key to navigating the final stages of the recovery phase. As a result, the case for convertible bonds remains strong and cautions against reading too much into the asset class' lag versus equities in the first part of the year. The equity asymmetric nature of the hybrid instrument makes them compelling assets for those who wish to maintain an equity exposure whilst dialling back their risk a bit.
- Convertible bonds' appeal is equally strong considering rising inflationary pressure for those who wish to maintain bond-floor defensive features. Thanks to their conversion option, convertible bonds have much lower interest rate sensitivity than straight bonds of similar duration. Though lagging equity markets year-to-date, convertible bonds are still outperforming all fixed income asset classes.
- Overall, we see the ongoing "recovery trend" as an opportunity to tactically diversify our investments, rather than a questioning of our long-term focus on quality and growth companies. With the economic cycle set to mature in the coming months, we believe that greater selectivity focusing on fundamentals will become critical again. This should benefit the convertible bond market through its large exposure to innovative companies in high growth segments such as the tech, healthcare or internet & distribution, that exhibit good earnings visibility and robust guidance.
- Although we expect the cyclical rotation still has legs, especially in those regions where the "economy reopening" is still early-stage (e.g. Europe), we stay cautious about the lack of visibility as to how fast their business activity can return to pre-crisis levels. In that respect, the rapid spread of the Delta variant in various parts of the world calls for caution when it comes to stock picking. In this context, we reaffirm our bias towards "quality" companies with strong balance sheet fundamentals.
- The recent record dynamism in convertible bonds' issuance has sparked a broad deepening and renewal of the investment pool, led by the "digital transformation" and "economies reopening" themes. Thanks to their dual nature, convertible bonds give investors the chance to be actively positioned on both themes with much lower volatility and downside risk than direct equity investments offer.

SRI Comment & Indicators

Holding comment: Focus on Etsy, Specialty Online Marketplace

- Founded in 2005 and listed in 2015, Etsy is an American retailer that has built its brand and the community on hand-crafted products and vintage items, strongly emphasizing sustainability, the human-to-human connection and supporting small businesses. The company embeds ESG into its corporate strategy and integrates ESG metrics into its financial reporting. The Etsy's platform connects 90M active buyers and 4.5M active sellers around the world through its platform. Domestic revenues represent the majority of sales (US 67%) followed by the UK (11%) with the top six product categories representing ~80% of sales (Homewares & Furnishings 35%, Jewellery & Accessories 16%, Craft Supplies 12%, Apparel 11%, Paper & Party Supplies 4% and Beauty & Personal Care 3%).
- Environmental issues are well addressed by Etsy which is the first major online shopping platform that introduced in 2019 carbon offset shipping by funding verified emissions reduction projects such as sponsoring wind and solar farms. In 2021 the group unveiled a new goal of reaching net zero emissions by 2030 following the Sciences-Based Targets initiatives. In addition to the net-zero goal, Etsy plans include (1) a 50% absolute reduction in Scope 1 and 2 greenhouse gas emissions, including Etsy's office operations and purchased energy; (2) and a 13.5% absolute reduction in Scope 3 greenhouse gas emissions, including seller shipping and fulfillment, using a baseline year of 2019. Currently, scope 3 emissions make up 99% of the company's carbon footprint. To reach the new goal, the company plans to increase its focus on working with sustainable vendors and suppliers and further its advocacy for the decarbonization of the logistics and transportation sector.
- In terms of social issues Etsy is exposed to human capital development topics as competition to attract and retain qualified personnel has historically been intense for the online retail industry. Etsy has implemented robust culture and practices, with a focus on fostering an inclusive and diverse environment for its workforce. Currently, Etsy's leadership team is 50% female, its workforce is 54% female and nearly a third of its engineers are female - double the industry standard. The group conducts engagement surveys and offers extensive benefit programs to boost employee morale and help mitigate talent attrition risks. Etsy is also exposed to cybersecurity and data privacy topics. The group has Privacy Policy which covers the user information, the choices and control that a user has in relation to this data based on type and sensitivity. Etsy protects sensitive information through various ways however still lacks some regular audits to test the integrity of its IT systems and prevent from growing cyber-attacks threats.
- Looking at governance, Etsy's governance practices appear to be in line with global peers with an independent board majority as well as independent audit and pay committee. Gender diversity appears strong with the board comprising 4 women out the 8 directors. There is no special capital structure with the principle of one share one vote, but shareholders have limited ability to nominate candidates and call for a special shareholder meeting. We also flag issues related to pay issues among others the director equity policy and the non-inclusion of sustainability performance criteria.

Sources: UBP, MSCI ESG Research.



Extra-financial performance indicators (June 30, 2021)¹

	Fund	Index²
Weighted average Carbon Intensity (tons CO2e / \$M Sales)	129.90	242.16
Exposure to fossil fuel reserves (%)	0.4%	4.3%
Diversity program (%)	50.4%	38.9%
Female directors (%)	32.3%	27.8%
Board independency (%)	81.7%	75.2%
Global Compact norm violation exposure (%)	0.0%	2.4%
Labor norm violation exposure (%)	0.0%	3.6%

¹Source: © 2021 MSCI ESG Research LLC (see important disclaimer on page 4). ²Refinitiv Global Hedged Convertible Bond Index (EUR).

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