UBAM – GLOBAL 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

- After the spike in volatility during March, the quarter started on a much quieter stance as equities rebounded and credit spreads and rates stabilized over April. With the US President Joe Biden and Kevin McCarthy, Speaker of the United States House of Representatives, eventually reaching an agreement to raise the nation's borrowing limit a new episode of volatility over the US debt ceiling has been avoided. Most of the quarterly equity market performance has actually been delivered in June, driven by technology and consumer names, in the electrical vehicle and travel themes in particular. Markets found support in the resilient US economy and less hawkish tone from the US Federal Reserve. The Fed rose its interest rate to 5.25% over the quarter, with only one rate hike of 25bps in May. In the meantime, the ECB increased its policy rates by 50bps and the BOE hiked twice for a total of 75bps. Their main focus is still inflation which hasn't fallen enough. US 10-year rate has risen by 36bps to 3.48% over the quarter. Overall volatility has fallen through Q2 across asset classes. High Yield credit spreads tighten during Q2 down by 53bps and 28bps in the US and Europe respectively.
- Major equity markets delivered positive performances over the second quarter of the year and global equities ended the quarter up 7.0% (MSCI World TR). In the US, the S&P 500 index increased by 8.7% quarter-on-quarter; cross-Atlantic, the Stoxx Europe 600 index lagged being up only 2.7% q/q and the Nikkei 225 index outperformed, up 18.5% q/q (all performance expressed in local currencies). In terms of investment styles, there was an outperformance of the Growth segment over the Value (10.6% q/q for the S&P Growth index, 4.0% ahead of the S&P Value index). US Quality small cap lagged with the Russell 2000 Quality moving only 4.2% higher.
- Being up 3.0%, convertible bonds exhibited an encouraging behavior showing its capacity to both rally when market environment improves and to mitigate downside risk.
- Primary market confirmed its rebound with the introduction of close to $20 billion of convertible bonds during the second quarter of 2023. The US contributing $14.3bn, Europe $2.0bn and Asia $2.5bn and Japan $0.8bn. H1 2023 issuance has reached $40bn. This is 4 times the level seen in H1 2022 and in line with pre-coved trend ($76bn issued annually between 2010 and 2019).

Performance Review

- Over Q2, UBAM – Global Convertible Bonds (IC EUR share class) posted a net return of 1.5% bringing the year-to-date performance to 2.8%. This is behind its Global convertible bonds universe (represented by the Refinitiv Global Convertible Bond index hedged in Euro, "the index") which returned 3.0% q/q and 7.0% since the beginning of the year. Most of the underperformance is coming from the US region. During Q2, underperformance was driven by companies displaying weak financial fundamentals, more specifically heavy balance sheets such as cruise liners. We tend to be structurally underexposed to this type of companies as we focus on strong credit quality. In terms of sectors, we have seen a strong upward movement on the back of the enthusiasm over generative AI which boosted technology names. It has had some positive knock-on effect on the semi-conductor sector. At issuer level, top absolute contributors in Q2 include MongoDB (US Software & Services), Palo Alto (US Software & Services), and Datadog (US Software & Services). Main detractors were Sea Ltd (Asia Communication Services), Jazz Pharmaceuticals (US Healthcare) and Solaredge (US Semiconductors).

All performance figures are given net of fees. Past performance is not a guide to current or future returns. See full disclaimer at the end of the document.

Portfolio Activity

- At the end of June, the average equity sensitivity of UBAM – Global Convertible Bond stands at 42.7% (+4.7q/q), 4.3pts above its index. The strategy's interest rate sensitivity moved slightly lower, at 1.5 for a 3.1-year duration. The average credit spread of the portfolio remained relatively stable over the quarter and our credit profile remains very solid at 213bps and lower its index, 367bps.
- From a geographical standpoint, the fund is primarily exposed to equity markets through investments in the US (24.6%). Investments in Europe account for 13.7% and Asia and Japan for 1.6%. Relative to the index, the portfolio exhibits an average overweight stance to Europe (+6.6 pts equity sensitivity), while slightly underweight with the benchmark's US exposure (-1.9pts) and less exposed to Asian (-3.3pts) markets.
- Supported by a busy primary market we initiated several new positions that are in line with our Quality positioning. On the US market we participated in the Duke Energy 4.125% 2026, a utility company and the World Kinect 3.25% 2028, a logistic company in the Energy industry. We also participated in the new issue from Dexcom, which has a maturity in 2028. Therefore, we are now invested in the company via two convertibles, maturity 2025 and 2028. The new issue from Lumentum, with a maturity in 2029, was an opportunity to operate a partial switch from the Lumentum 2028 into a more balanced profile. In Europe, we took part to the Lagfin exchangeable into Campari 3.5% 2028 and the Voestalpine 2.75% 2028, an Austrian company in the steel industry. Over the quarter, we have made some arbitrage in our positions to rebuild exposure to more convex convertible bonds. It was the case for Halozyme, STMicorelectronics and Edenred where we switched for convertibles with longer maturity. We took profit on names in the software sectors such as MongoDB (post-earnings strong performances), Datadog and Cyberark. We closed our position in Silicon Labs in April, as the company announced they will redeem the convertible by end of June 2023. We also started to take profits on LVMH as after good performances the convertible bond has now a more equity-like profile.

Outlook

- Over the first months of the year central banks have continued to tighten their monetary policy, the upper bound of the Fed fund rates is now at 5.25% and the ECB's deposit rate is at 3.5%. The strong labor market and lower inflation legitimate their actions. That being said, the macroeconomic environment has shown signs of a desynchronized cycle both regionally and in sector terms. Economic surprise index in Europe has been falling sharply while the US one has shown more resilience. In this context, uncertainty around the future decisions from central banks persists and the uneven market performances create confusion. Indeed, we noticed that for the S&P 500, 5 out of 11 sectors, under the GICS classification, are still in negative territory year-to-date while 3 sectors have performances above 30%.
- Equity and bond markets are sending mixed messages and rather opposite views of the current state of the cycle. In one hand market implied rates are anticipating the first cut from the Fed as soon as Q1 2024, which is in line with significant slowdown in economic growth. In the other hand, equities are rising, and consensus expectations are showing a rebound in earnings growth by Q1 2024, this would be supported by stronger economic activity.
- We stay cautious as the strong momentum in equity markets is not a proper reflection of the current economic environment. With growth slowing down, mixed economic indicators and tighter credit conditions we believe it is paramount to invest in companies with strong fundamentals.
- Convertible bonds underlying equities are not expensive anymore and yield is back in the convertible bond universe. As a result, the outlook for convertible bonds is positive thanks to restored multiple performance drivers: underlying equity upside potential, yields and credit.
- Convertible bonds offer portfolio diversification and allow investor to maintain an exposure to the equity market while containing its downside risk. Over the medium-term convertible bonds have the potential to deliver better risk-adjusted returns.

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