UBAM – EMERGING MARKET CORPORATE BOND SHORT DURATION

Quarterly Comment

For Professional Investors in Switzerland or Professional Investors as defined by the relevant laws.

Market Comment

- The fourth quarter was marked by investors' growing optimism as uncertainties linked to the US elections faded while vaccines started to be approved and to be rolled out in several countries.
- With hopes that these vaccines would open the way for a rebound in the global economy, the US treasury curve steepened. 2-year US Treasury rates were down -1 bp to 0.12% while 10-year rates up +23 bps to 0.91%.
- Commodities were also strong. The CRB index was up by 13.0%, thanks notably to the rally in metal prices (iron ore +35%, copper +16%, silver +14%). Oil prices also rebounded by over 20%, with Brent ending the year at 51.8 USD per barrel, a level not reached since end February. Gold, given its safe-haven status, underperformed (+0.7%).
- Overall, EM corporate bonds returned 4.29% over the quarter, with spread tightening by 69 bps to 316 bps.
- High Yield bonds outperformed as risk appetite increased, returning 6.41%, with spreads down by 102 bps. Investment grade bonds returned 2.87% thanks to a spread tightening of 48 bps.
- At a regional level, the best performance came from Africa (6.9%) and Latin America (+6.4%). In contrast, Asia (+2.9%) and the Middle East (+3.3%) underperformed.
- At a country level, the best performance came from Ghana (+33.5%), followed by Argentina (+12.9%) and Ukraine (+10.9%).
- In contrast, the worst performance came from lower beta, higher-rated countries like Poland (+0.5%), Korea (+1.3%) and Taiwan (+1.4%).
- At a sector level, the best performance came from commodities sectors: Pulp & Paper (+7.8%), Metals and Mining (+6.8%) and Oil & Gas (+6.2%). In contrast, lower beta sectors like Infrastructure (2.9%), Financials (3.2%) and Utilities (3.3%) underperformed.
- The shorter end of the credit curve continues to outperform in spread terms, with 1-3 year spreads tightening by 132 bps while 7-10 year spreads tightened by only 74 bps. Performance-wise, 1-3-year EM corporate bonds returned +2.5%, while 3-5 year bonds were up +3.3%.
- Over the year, all maturities EM corporate bonds returned 7.35%, thanks primarily to the rally in US Treasury, as well as to carry. 1-3 year bonds returned 4.6%, while 3-5 year bonds returned 6.7%.

Performance Review

- Over the quarter, the fund returned +2.98% net of fees, benefiting primarily from the spread tightening and its high carry.
- All regions contributed positively, led by Latin America and Asia.
- At a country level, the best performance came from our holdings in Colombia, South Africa, Brazil and China. No country posted negative performance.
- All sectors contributed positively. The best performance came from Industrials, Sovereign and Financials.

- Over the year, the fund returned +5.01% net of fees, benefiting primarily from its high carry as well as from the fall in US Treasury yields. The spread effect was negative, however.
- All regions contributed positively, led by Latin America and Africa.
- At a country level, the best performance came from our holdings in South Africa, Colombia, China, Russia and Brazil.
- In contrast, our holdings in Ghana, Chile, Geogia and Mongolia proved costly.
- All sectors contributed positively. The best performance came from Industrials, Banks, Sovereigns and Consumer Products.
- The fund also benefited from its allocation to US and Europe HY, via CDX

Portfolio Activity

- Over the quarter, our scorecard moved from “balanced” to “dynamic” territory. Hence, we increased our market exposure held through CDX to about 17% from 6.2% at the end of September. We also maintained a longer spread duration than interest rate duration given the risks of rising US rates.
- The fund received significant inflows into year end, with assets under management rising to USD 445 mln from USD 307 mln at the end of September. As a result, our cash position increased, as we looked for attractive opportunities in short-dated paper.
- As we invested those assets, we favoured high yield issuers.
- We increased holdings in Sovereign bonds to 11% of the fund, adding for instance Benin, the Dominican Republic, Egypt and Guatemala.
- We also increased Oil & Gas companies in Colombia, Saudi Arabia and Russia.
- In contrast, we reduced exposure to Metals & Mining (Brazil, Russia).

Outlook

- With the roll-out of vaccines across the world, the global economy is expected to rebound in 2021. This rebound should be faster in Emerging Markets, led by Asia, than in Developed Markets.
- EM corporate fundamentals look solid, with notably less leverage than in the US. This means that we can expect defaults rates to come down in 2021 and to remain lower in EM than those in the US, as was the case last year: in 2020, EM HY corporate defaults stood at 3.5% vs 6.8% in US HY.
- In parallel, with the stock of negatively yielding debt reaching USD 18 trillion and the historically low yields of DM credit markets, investors are expected to continue to look at EM debt as an asset class of choice, leading to new inflows as experienced in late 2020.
- In that context, EM corporate bonds, with their lower volatility and higher Sharpe ratios than EM sovereign debt or EM local debt, appear very appealing.
- We expect inflows into short-dated bonds to be sustained. Indeed, these appear attractive, with spreads of around 300 bps for 1-3- and 3-5-year paper vs only 230 bps in 7-10-year bonds. Moreover, their lower duration would provide a cushion in the case that the rebound of the US economy translates into a steepening of the US interest rate curve.

- At a country level, our largest positions are in China, Russia, South Africa, Colombia and Brazil.
- At a sector level, our largest positions are in Sovereigns, Industrials, Consumer companies and Oil & Gas.

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Union Bancaire Privée, UBP SA Rue du Rhône 96-98 | P.O. Box 1320 | 1211 Geneva 1 | Switzerland **ubp@ubp.com** | **www.ubp.com**