UBAM – EM SUSTAINABLE CORPORATE BOND

Quarterly Comment

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

Market Comment

- After the sharp collapse in risk assets in March, triggered by the COVID-19 pandemic, the second quarter of the year saw a strong rally. This was supported by the series of massive monetary and fiscal packages put in place by DM and EM central banks and government authorities to cushion the effects of the lockdowns on the world economy. Indeed, while these measures will not prevent a global recession, estimated at -4.9% by the IMF, market participants saw them as a sign that a worse outcome would be avoided.
- Also, as the quarter advanced, there were signs that the pandemic was receding, with lockdowns being gradually eased in several countries, which led to a pick-up in economic activity, notably in China.
- US treasury yields continued to come down on the back of quantitative easing, but with much reduced volatility: 2-year US Treasury rates were down by -10 bps to 0.15% while 10-year rates fell by -1 bps to 0.66%.
- Commodities rebounded, with the CRB index up by over 13%. Oil prices had their best quarter in 30 years after the OPEC+ finally reached an agreement to cut production by 9.7 million barrels per day starting May 1 – agreement which was extended early June to the month of July (-9.6 bbl/day). Some weakness late June was felt as new cases of the virus appeared in some countries, raising fears that this could trigger a return of lockdowns. But this was compensated by a reduction in US crude stockpiles later in the month. Overall, Brent prices jumped by 81%, ending the quarter over $41/bbl, while WTI almost doubled to $39/bbl. Metal prices also shot up, with silver and iron ore rising by 30%, copper +22% and gold +13%.
- In EM bond markets, this better tone helped liquidity to come back gradually, outflows to stop and the primary market to reopen.
- Overall, EM corporate bonds returned 11.5% over the quarter, with spread tightening by 159 bps to 414 bps.
- High Yield bonds outperformed in the rally (+15.4%) as spreads tightened by 273 bps to 617 bps. Investment Grade bonds rose by 9.0%, with spreads down by 108 bps to 289 bps.
- At a regional level, the best performance came from Africa (+27.9%) and Latin America (+14.4%). In contrast, Asia (+8.0%) and the Middle East (+10.3%) underperformed.
- The best-performing countries were Ghana, posting an impressive +123.6%, as Tullow Oil bounced back from its lows in March after it managed to sell non-producing assets in Uganda for US$575mn, which boosted their liquidity without reducing production or EBITDA. The company also announced the appointment of a new CEO and benefited from the rebound in oil prices. South Africa (+33.7%) and Argentina (+32.9% - with some progress made in the debt restructuring negotiations between the government and bond holders) also performed strongly.

On April 1, 2020, UBAM – EM Sustainable High Grade Corporate Bond was renamed UBAM – EM Sustainable Corporate Bond. On June 8, 2020, the fund widened its investment guidelines to include HY issuers.

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.

- In contrast, countries dominated by IG issuers like Taiwan (+2.4%), Poland (+2.5%), Hong Kong (+3.9%), Korea (+3.9%) as well as Bahrain (+3.3%) underperformed.
- At a sector level, the best performance came from commodity sectors: Metals & Mining (+19.9%), Pulp & Paper (+18.8%) and Oil & Gas (+16.0%). Industrials (+16.6%) also performed well. In contrast, Transport companies underperformed (-9.0%) as lockdowns and the bankruptcy of Latam Airlines weighed on the sector. Diversified companies (+7.3%) and Financials (+7.6%) also underperformed.

Sources: UBP, Bloomberg Finance LP, BofA, JP Morgan

Performance Review

- Over the quarter, the fund returned 6.41% net of fees. As an indication, the reference index* was up 8.41%. (Note that as of June 9, the reference index* changed to JP Morgan CEMBI Diversified from JP Morgan CEMBI Diversified High Grade – see more details in the Portforlio Activity section below.)
- Performance attribution shows that the fund suffered primarily from its credit selection, notably because of our ESG-quality bias, as distressed debt and commodities-linked sectors performed strongly over the period. Our duration and curve positioning contributed positively, however.
- Country-wise, the best performance came from our overweight in Chile, overweight and selection in India as well as from our underweight in Israel, Taiwan and Indonesia.
- In contrast, our underweight and selection in the UAE, selection in South Africa, overweight in Singapore and Hong Kong, and underweight in Saudi Arabia proved costly.
- Sector-wise, the fund benefited from its underweight and selection in Utilities. In contrast, our selection in Oil & Gas, underweight in Financials, overweight in TMT and underweight in Metals & Mining proved costly.
- The fund suffered also from its cash holdings post merger as we divested from poor ESG issuers and could not reinvest all cash immediately by lack of attractive opportunities.

**Index provided for comparison and information purposes only. The fund has no official benchmark.*

Portfolio Activity

- During the first two months of the quarter, we did not change our positions, as the fund had held well through the sell of and we were confortable with the selection of holdings as the market rebounded.
- On June 8, investment guidelines were widened to authorise the fund to invest in both investment grade (IG) and high yield (HY) issuers. On the same day, the fund absorbed UBAM – Emerging Market Corporate Bond, a fund invested in EM IG and HY bonds, expanding its AUMs to 87.6 mln at the end of the quarter.

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- Despite this widening of the investment universe, the fund's investment process and ESG guidelines are mostly unchanged, including normative and business involvement guidelines.
- This change allowed us to significantly diversify the fund's holdings. The number of issuers more than double to close to 100 across 27 countries from respectively around 40/17 before the merger.
- The main change is the addition of HY issuers, which now represent close to 35% of the fund. Most of these issuers are BB-rated. The fund is underweight in single-B rated names, compared to its index, and holds no issuer in the Cs and D rating bucket.
- Sector-wise we added holdings in TMT, Metals & Mining and Consumer companies. In contrast, we reduced our holdings in Financials and Oil & Gas.
- At a regional level, the broadening of the universe to ESG-minded high yield issuers allowed us to increase exposure to Africa and Europe, at the expense of Asia and the Middle East.
- New countries in the portfolio include Guatemala, Indonesia, Israel, Peru, the Philippines, Saudi Arabia, Taiwan, Turkey and Ukraine.

Outlook

- Volatility has come down and liquidity has improved but the impact of the pandemic-induced lockdowns on global growth is sharper than initially expected. Over the medium-term, we see as a positive the forceful reaction of public authorities around the world. Many EM central banks have decided to cut rates while some governments have also announced fiscal measures. The US Federal Reserve's Quantitative Easing will put pressure on the US Dollar, which in turn will continue to reflate financial assets and commodities.
- While the world is entering a global recession, EM economies are expected to fare better than DM thanks to the earlier rebound of Asia, as well as to the vast diversity of EM economies. We thus expect the gap in economic activity between EM and DM to widen again, which should contribute to attract further capital flows towards EM.
- Already, inflows into EM corporate bonds have picked up again and supported the better tone in the market experienced since early April. Primary markets have reopened allowing many sovereign and corporate issuers, both IG and HY, to refinance.
- Still, the economic slowdown has a negative impact on issuers creditworthiness, leading to a rise in the number of rating downgrades and for some even, default. Issuer selection remains thus of paramount importance, so we are relying on our credit analysts to avoid negative credit events, with special focus on:
    - Issuers' capacity to generate operating cashflows and maintain a good level of activity, and keep adequate liquidity
    - Their capacity to refinance
    - Their ability to support the leverage accumulated during the crisis

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- Their sustainability response to the pandemic
- Valuations to identify attractive opportunities (overly penalised issuers)

- At a country level, our largest overweight positions are in Hong Kong, South Africa, Chile, India and Singapore.
- Our largest underweights are in China, Israel, Saudi Arabia, Brazil and Turkey.
- At a sector level, our largest underweight is in Financials while our largest overweight is in TMT.

ESG Metrics

- At the end of the quarter, the overall ESG Quality Score of the portfolio stood at 6.50 (equivalent to an MSCI ESG Rating of A) vs. 3.48 for the index (equivalent to an MSCI ESG Rating of BB) (@2020 MSCI ESG Research LLC).
- The weighted average carbon intensity[1] of the fund was 446.9 tons CO2e/$M sales revenues v. 678.8 tons CO2e/$M sales revenues for the index. (@2020 MSCI ESG Research LLC).

[1] taking into account subsidiary mapping

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