UBAM – EUROPEAN 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

- Q4 2022 was characterized by a further slowdown in global growth and emerging signs of peaking inflation across developed economies. During the fourth quarter of the year the Federal Reserve had been sending signals to prepare the market for a slowdown in the pace of rate hikes and, after four consecutive 0.75% hikes, it rose its key rate by 0.50% in December. The Federal Reserve increased its policy rates totaling a 125bps hike from 3%-3.25% to 4.25%-4.50%. In the meantime, the European Central Bank and the Bank of England rose their rates by 125bps and 100bps to 2.50% and 3.50% respectively. Central banks' focus is currently on the labour market that remains too tight. In this context, risky asset strongly rallied in October and November before going through a tumultuous December. European equity markets posted a positive quarterly performance after three consecutive quarter of market losses. Over the quarter, the US and German 10-year rate rose by 5bps to 3.87% and by 46bps to 2.57% respectively. European credit spreads tightened for both IG and HY by 55bps and 131bps respectively by the end of December.
- Eventually, global equities ended the quarter 6.8% higher (MSCI World TR hedged in euros), bringing their performance over 2022 to -17.9%. In Europe, the Stoxx Europe 600 index was up 9.8% q/q. In terms of investment styles, the “Value” play outperformed the “Growth” overall, as revealed by the MSCI Europe Value index up 12.1% q/q, 5.1% ahead of the Growth index.
- In this context the asset class exhibited an encouraging behavior showing its capacity to both rally when market environment improves and to mitigate downside risk.
- Primary market confirmed the rebound seen in Q3 as global markets introduced $13.2 billion of convertible bonds during the last quarter of the year. The US contributing $8.9bn, Europe $3.0bn and Asia $0.9bn and Japan $0.3bn. After two record years of issuance, the decline in 2022 was sharp. Overall, in 2022, global convertible issuance is still relatively low and totalized $39bn including $28.5bn in the US, $6.2bn in Europe, $4.2bn in Asia and $0.4bn in Japan.

Performance Review

- In Q4, the UBAM – European Convertible Bond increased by 4.4% after fees (IC EUR share class), slightly behind its index, the Refinitiv Europe Hedged Convertible Bond index (EUR), by -0.5%. Overall, in 2022, the strategy is down -16.7% after fees, lagging the index by 0.9%.
- The main contributing sectors were Information Technology (+140bps), Consumer Discretionary (+89bps) and Financials (+80bps). while Utilities (-2bps), Consumer Staples (-6bps) detracted to the overall fund performance. At issuer level, top contributors over the quarter include BE semicondutor (+46bps), Sika (+42bps) and LVMH (+37bps). Conversely, our investments in GN Store (-3bps), JDE Peets (-8bps) and GTT (-13bps, closed in December) hurt performance. Relative to the index, main contributors are BE semicondutor (+43bps, overweight), Orpea (+39bps, not in our portfolio), and LVMH (+32bps, overweight), while main detractors include our exposures to Delivery Hero (-24bps, underweight), IAG (-28bps, not in our portfolio) and Safran (-42bps, not in our portfolio).

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 December, the average equity sensitivity of UBAM – European Convertible Bond stands at 30% (+7pts q/q), +3pts above the index's. The strategy's interest rate sensitivity is very much contained at 2.0 for a 3-year duration. Lastly, the portfolio exhibits an average credit spread of 169bps (-31bps q/q) vs. 278bps for the index – levels that reflect the "quality" bias inherent to our security selection process.
- From a sector standpoint, the sub-fund is primarily exposed to equity markets through investments in Information Technology (7%, +1pts q/q), Industrials (6.2%, +3.8pts q/q) and Financials (4.9%, +1.5pts q/q). These are the sectors that concentrate most of our current equity sensitivity overweight versus the index.
- We continued to strengthen the positioning of the portfolio focused on quality companies over the quarter, and therefore closed our positions in MTU Aero Engine., Then trades mainly involved risk adjustments and primary market opportunities. Over the last quarter of the year, we took some profits on names that rebounded sharply such as Edenred, LVMH, Deutsche Post and Sika. In December was announced the early repayment by Engie of its GTT exchangeable bond. For that reason, we sold our entire position in this name, one of the best contributors to the performance of 2022. In the energy sector, we closed the position we had on Total as it was reaching maturity. As we've seen more activity on the primary market during the last 3 months of the year, we participated in three European issues: Ubisoft 2.375% 2028, the GBL exchangeable into Pernod Ricard 2.125% 2025 and the new Iberdrola 0.5% 2027.

Outlook

- The year 2022 will be remembered for the sharp rise in short and long rates that penalised all asset classes. Although several developed economies are on track to experience further economic weakness this year, recent evidence suggests that the overall impact could be smaller than previously anticipated. Overall, we do not anticipate a collapse in global growth given the strength of labour markets within developed economies, whilst Asian countries should provide support to the growth backdrop amid Chinese reopening. 2023 should see a lull in the rise in short rates, while maintaining strong tension on long rates. Markets are likely to be less directional and less adverse. Dispersion could be particularly high in the equity markets and 2023's expectations are starting to reflect downward earnings revisions that could lead to an extended period of volatility.
- In this context, convertibles are clearly in better shape, and we focus on quality companies from both credit and fundamentals standpoints. The secular growth bias of our market should be supportive, thanks to reduced upside pressure on interest rates in 2023 and attractive valuations at current level. In the wake of the market correction, companies issuing convertible bonds suffered a massive de-rating since their valuation peak in 2021. They now appear more attractive given still strong fundamentals and growth prospects. At this level, it is an opportunity for investors to rebuild exposure on equities through convertible bonds considering the potential offered by the embedded option trading significantly out of the money.
- After being negative for a while, yield in the convertible universe has now moved into positive territory. Close to 50% of the convertible bond universe offers a yield >5%. This constitutes a return driver that has been missing for a several years:
- 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.

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