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

- During the first quarter of 2024, markets have continued their way up and reached record highs, it has been the case for the S&P 500, the Stoxx 600 and the Nikkei 225. Performances have been driven by the resilience of the US economy and the strong corporate earnings reports. The “Higher for Longer” rhetoric made a comeback in February and rate cuts expectations have been pushed to later this year. US Federal Reserve, the Bank of England and the European Central Bank kept their interest rates unchanged over Q1. Three rate cuts by the US Federal Reserve are priced for 2024 vs. six at the end of last year. Jerome Powell’s communication did not change much. They are still “data dependent” and keep a close eye on inflation which is still elevated to them while economic activity and labor markets are not yet facing any weakness. In this context yields have moved higher globally, and they reached new YTD highs at 4.32%, 2,46% and 2,94% for US, German and French 10-year yields respectively over the quarter. In the US, the 2-year to 10-year part of the yield curve moved higher by 30bps to 40bps. In France and Germany, we’ve seen a similar pattern, but stronger on the 2-year to 5-year part of the curves with upward shift reaching close to 45bps. Overall, it did not alter the upward trend of equity markets, and volatility was stable during the first three month of the year. High Yield credit spreads barely moved as they were just slightly up 4bps and 5bps in the US and Europe respectively.
- Major equity markets posted strong gains over the first quarter of the year ending at +9.0% (MSCI World TR). In the US, the S&P 500 index increased by 10.6% quarter-on-quarter; cross-Atlantic, the Stoxx Europe 600 index was behind being up 7.8% q/q. Japanese equities do not stop rising and the Nikkei 225 index moved higher by 20.8% q/q (all performance expressed in local currencies). Equity performances were mainly driven by large and mega-caps, led by the “Magnificent seven”, and small caps lagged, and the Russell 2000 rose by 5.2%. That being said, small and mid-caps have started to catch up with large and mega caps in March.
- Weak performances of small caps are reflected in the underperformance of convertible bonds’ underlying equities, 2.6%. In this context, convertible bonds ended the quarter 2.3% higher.
- Primary market activity was strong during Q1 2024 with $25.6bn issued. It was almost fully done by the US market which saw 34 new issues, for a total of $20.7bn. In Japan, there were 7 new convertible bonds for $2.9bn. It was relatively quiet in Europe where only 3 new convertible bonds and 1 exchangeable bond issued totaling $1.5bn. In Asia ex-Japan, there was only one new convertible bond for $0.4bn.

Performance Review

- Over Q1, UBAM – Global Convertible Bonds (IC EUR share class) posted a net return of +1.5%. This is behind its Global convertible bonds universe (represented by the Refinitiv Global Convertible Bond index hedged in Euro, “the index”) which returned +2.3% q/q. Most of our performance was led by names in the Industrials, Consumer discretionary and Health Care sectors, while our exposure to Softwares detracted the most. At issuer level, top relative contributors in Q1 include our call option on the Topix index, Saipem (Europe Energy, overweight), and Schneider Electric (Europe Industrials, overweight). Main relative detractors were Safran (Europe Aerospace & Defense, not in portfolio), Rheinmetall (Europe Aerospace & Defense, not in portfolio), and Microstrategy (US Software & Services, underweight).

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 March, the average equity sensitivity of UBAM – Global Convertible Bond stands at 47.9% (+4.4/q), above its index. The strategy's interest rate sensitivity is relatively unchanged at 1.6 for a 3.4-year duration. The average credit spread moved slightly lower over the quarter; tightening by 18bps, and our credit profile remains very solid at 196bps and lower its index, 308bps.
- From a geographical standpoint, the fund is primarily exposed to equity markets through investments in the US (28.5%). Investments in Europe account for 9.5% and Asia and Japan for 8.6%. Relative to the index, the portfolio exhibits an average overweight stance to Europe (+4.3 pts equity sensitivity), overweight Japan (+2.8pts), while marginally less exposed to US (-0.7pts) and in line with Asia and Pacific exposure (+0.1pts).
- On the back of the strong primary market, we initiated exposure to new names and repositioned the portfolio on more balanced bonds. Overall, we moved the portfolio towards convertible bonds with more balanced profiles to ensure we maintain convexity level. Among others, we opened new positions on Global Payment and the new Nextera Energy 2027. We participated to the new exchangeable Citi / LVMH 1% 2029 and closed our position on the JP Morgan / LVMH 0% 2024. We made a partial switch from the Schneider Electric 0% 2026 towards the more balanced Schneider Electric 1.97% 2030. We moved from the Winnebago 1.5% 2025 to the newly issued Winnebago 3.25% 2030. With a similar approach we switched from the Parsons 0.25% 2025 to Parsons 2.625% 2029. We closed our position on Cyber Ark, SSR Mining and ZTO. We have been taking profits and reducing our exposure to some names such as Zscaler, Edenred, Akamai, Datadog, Prysmian and Schneider Electric or in health care space, Dexcom and Conmed. We increased our exposure to Japan by participating to the Daiwa House 0% 2029 and the Ibiden 0% 2031.

Outlook

- While inflation pressures are easing, it is not yet sufficient to trigger the first rate cut. The strength of the US economy supports the current Federal Reserve *wait & see* and *data dependent* approach. As a result, interest rates could stay at current level slightly longer than initially expected. In Europe, central bankers are giving a bit more visibility with a potential first rate cut as soon as June. This should be put into perspective with the strong US economy and signs of stabilization in European economic activity. Furthermore, we recently saw a rebound in PMI indices in the US and some improvement among investor sentiments in Europe. It underpins a new scenario characterized by modest growth and falling inflation. When put together, these factors could frame an environment supporting further broadening of equity performances beyond mega caps and "Magnificent Seven". The catch up from small and mid-caps could intensify in Europe and the US, as they should continue benefitting from their attractive valuation. This would be a positive scenario for our asset class given the convertible bond bias towards smaller companies.
- Convertible bonds would also benefit from their fixed income features supported by an accommodative interest rate environment and tighter credit spreads.
- In addition, primary market is expected to be busy, thanks to refinancing activity. In the convertible bond space alone $90bn worth of debt is due to mature in the next two years. Backed by the potential of financial debt costs savings, we believe the pool of corporates considering the convertible bond market should expand beyond its traditional issuers to High Yield and even Investment Grade issuers. The primary market speeding up and appealing new deal terms offering higher convexity potential, should foster the good momentum of the asset class.
- From a macroeconomic viewpoint, we should not ignore the desynchronization in economic cycles between Europe and US, and geopolitical tensions which could exacerbate divergence. We do not under-estimate the risk of seeing volatility navigating to a higher level. When combined, this tends to refrain risk-on positioning among investors. This type of foggy market environment is precisely when convertibles should be considered to build or maintain an equity exposure.

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