Q1 2024

U ACCESS – CHINA 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 markets tumbled at start of the year, as a sense of panic grappled investors, Chinese equity markets strongly rebounded post Chinese New Year. Rally has been triggered by renewed talk of support from officials and state funds actively purchasing equities. In addition, the holiday season triggered stronger consumption for travel related goods and services such as takeout. Furthermore, the global trade cycle has started to turn, which help to support Chinese industrial production. When combined this provided some relief and helped investor sentiment to improve. In this market environment, private-owned enterprises globally underperformed State-Owned Enterprises, +0.6% vs. +6.3% (CNH, total return) respectively. We also note the outperformance of large caps, which benefitted the most from the government-led stock purchases, over Small and mid-caps with the CSI 300 being up 3.3% vs. CSI 500 and CSI 1000 down 2.4% and 7.4% respectively.
- Over the past three months, best performing sectors of the A-share market were Energy (+17.3%), Utilities (+13.5%), and Telecommunication (+9.4%). At the bottom-end, Health Care (-11.0%), Real Estate (-7.3%) and IT (-6.6%) reported negative returns q/q.
- For the quarter ending 25th March 2024, China's domestic stock market (hereafter the "A-share market") rose by 4.6% (CSI 800 Total Return Index). For purpose of comparison, over the same period, Hong-Kong-listed mainland securities (the Hang Seng Index, HSML100) was up 3.4% (CNH, total return).
- During the first quarter, convertible bond issuance in domestic China totalled only CNY 8 billion through 8 new convertible issues. At March-end, they are 541 tradable convertible bonds in the Chinese onshore market, for a total outstanding amount of CNY 906 billion.

Performance Review

- In Q1, the strategy increased by 1.3% (U Access – China Convertible Bond IC CNH), below the on-shore convertible bond market (CSI Convertible Bond Index) by 0.2%*. Sector-wise, most of the performance is coming from our exposure to Financials, Materials, and Information Technology. Overall, our bond selection detracted -390bps to our relatively performance while sector allocation contributed 370bps.
- The Chinese equity market were down until early February before a V-shapre recovery and ended the quarter modestly higher, being up 4.6%. Over the same period, the on-shore convertible bond market (CSI Convertible Bond Index) was up only 1.4%.

Portfolio Activity

- The investment level of the U Access – China Convertible Bond portfolio remained above 95% for the whole period under review. In comparison to the investment universe, we maintained an underweight exposure to the Financial sector in accordance with our systematic approach which aims to ensure sufficient portfolio diversification. For purpose of indication, the portfolio's exposure level to the Financials sector was on average 13%, compared to an average weight of 31% for the universe. Likewise, the cumulative weight of the portfolio's top 10 holdings remained circa 10% (vs. 27% for the investment universe).

*Quarterly p*erformance calculated between the 27th December 2023 and the 25th March 2024. Index is for reference purposes only and no comparability or relevance is warranted or implied. For indicative purpose only, the strategy has no official benchmark.*

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 terms of risk profile, throughout the quarter, the portfolio allocation moved towards “bond-like” as the market was selling off. However, exposure to both the “balanced” and “higher equity sensitivity” segments was higher than the investment universe, and we had an underweight positioning to the “bond-like” segment.
- At March-end, the portfolio exhibits an average equity sensitivity of 44.5%.

Outlook

- China’s Q1 GDP exceeded expectations, expanding at 5.3% y/y vs projected 4.8% y/y. Although GDP surprised to the upside, other activity indicators came in weaker-than-expected in March. However, we’ve seen some interesting development in the Chinese economy that could help stabilization and provide support for a continuation of the positive momentum seen since the 5th of Feb. PMI indices, both manufacturing and non-manufacturing, have moved back above 50 indicating expectations of activity expansion. China remains vertically integrated in global value chains, and so will also benefit from improving external demand. We expect that exports will no longer be a net drag in the first half of 2024. Challenges are still there though. property investment was more contractionary, reaching -9.0% YTD y/y. It may still take several months before real estate activity indicators stabilize, and we expect a slow recovery once that inflexion point is achieved. More support measures will be required to achieve a soft landing of the property sector in the second half of 2024. We are anticipating additional measures aimed at boosting consumption to avoid a fading momentum.
- A-share equities 5Yr Cyclically Adjusted Price-to-Earnings ratio fell by 30% at 11.8x (vs. 15.1x historical average) over the last 2 years, close to its lowest level seen in 10 years. To our view this could represent an attractive entry point for long term investors. However, the high volatility associated with A-shares has historically been a drawback when considering exposure to onshore China. Thanks to their dual nature, convertible bonds give investors access to A-shares with lower volatility and reduced drawdown risk.
- Our U Access – China Convertible Bond strategy follows a systematic selection & allocation approach. The latter has been designed to provide investors with a liquidity-enhanced and diversified exposure to China’s on-shore convertible bond market, which can navigate the A-share market’s bouts of volatility, as evidenced by the outperformance achieved by the strategy since its inception compared with both the equity market and the convertible bond universe.

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