Q1 2023

UBAM – EM RESPONSIBLE CORPORATE 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

- The year began with positive sentiment on the growth outlook as energy costs fell and China's economy reopened. However, February and March saw US-China tensions re-escalate and a widespread loss of confidence in US and European banks. The Fed hiked rates to new highs and further reduced liquidity. EM has benefited from the shift of relative growth momentum with a rebounding mainland China and surprisingly resilient Europe. EM central banks generally were not constrained by financial stability concerns and remained focus on inflation. The collapse of Silicon Valley Bank in mid-March and the later Credit Suisse bought by UBS in a deal brokered by the Swiss authorities, reduced concerns over re-accelerating inflation. It caused a sharp rally in government bond markets due to fears of a possible banking crisis, where government bond markets went from pricing in rate hikes to discounting sizeable rate cuts. Following the strains on the US and European banking sector, EM Financials conversely did well during the first quarter.

- Emerging Markets bond flows have seen an increase of +$2.1bn since the beginning or the year, where a widening EM-DM growth differential and a more benign dollar supported EM capital flows, according to data and research forecast from JP Morgan.

- Over the quarter, EM Investment Grade corporate bonds outperformed the broader EM Corporate universe, returning +2.02% while their High Yield counterparties returned +1.82%, outperforming the broader index.

- In the EM Corporate IG space, at a regional level, Asia (+2.9%) fared better than others, followed by Middle East and Latin America (both +1.2%).

- At a country level, the best performance came from Malaysia (+4.4%), Thailand (4.2%) and Taiwan (+3.7%). The worst performance was delivered by Egypt (-2.2%), Nigeria (-1.6%), and Panama (-1.4%).

- At a sector level, the best performance came from Diversified (+4.6%), followed by Oil & Gas and TMT (+3.1%). Infrastructure constituted the worst performing sector (+0.8%).

Sources: UBP, Bloomberg Finance LP, JP Morgan

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.

Performance Review

- Over the quarter, the fund returned -0.57% net of fees compared to +1.95% for the JP Morgan CEMBI Diversified index.
- Top-down overlay, mainly duration management with an active short duration of -1.3 yrs at the beginning of the year due to a view of stickier inflation and base rates higher for longer. However, rates rallied in January and our view turned out to be market’s view only in February. This explains 158 bps of the underperformance.
- An UW in Asia including China, and Macau (UW in Macau gambling sector on the back of our ESG policy). We have high conviction on this underweight positioning due to relatively weak issuers’ credit metrics, poor governance, and tight valuations for the risks implied and compared to issuers from other regions such as Latin America. We believe this position is going to bare its fruits, however, in the short term it has cost us 16 bps vs the benchmark.
- An OW in Latin America especially in HY issuers (it has cost us 83 bps vs the benchmark). We maintain our positioning as these issuers offer attractive spreads and yields for the risks implied on a relative basis vs other regions such as Asia.

Portfolio Activity

- Over the quarter, we increased our exposure to Africa, Asia ex Japan and the exposure to Middle East. On the other hand, reduced in Latin America.
- In Africa, we added to our exposure to South Africa mainly in Metal & Mining and TMT sectors
- In Asia ex Japan, the exposure in Hong Kong and Korea was increased through to Financials and Industrials sectors. China exposure in Industrials was also added.
- In Middle East, Qatar exposure in Oil & Gas was reduced, and Israel increased in Financials.
- In Latin America, Mexico exposure was increased in Industrials sector but reduced in local debt, other countries had a slight increase in their exposure such as Costa Rica in TMT, Peru in Metals & Mining and Colombia through Oil & Gas sectors.

Outlook

- Although the high volatility in US base rates has been seen a the sharp decrease in yields on the back of financial stability concerns during the first quarter, we think we are close to the end of Fed's hiking cycle and the main part of US base rates adjustment is behind us. The significant market repricing of monetary policy trends for core CB has also led to a reassessment of the next steps for EM CB. Expectations for cutting rates on several EM CB (in LatAm and CEEMEA) in the next year are now higher. For the few countries where further tightening is expected (Thailand, Mexico, and South Africa), markets are pricing a more accommodative stance.
- With regards to EM corporates, as in previous months, the outlook for 2023 is more challenging compared to 2022, on the back of the tighter financial conditions and increased inflation that will exert their full impact on corporates' financials figures during this year. However, on an aggregate level EM IG corporate credit fundamentals remain healthy having deleveraged in past years and having extended their debt maturities at lower interest rates taking advantage of the low interest cycle prior to the quantitative tightening cycle.
- Additionally, EM IG corporate valuations (spreads) look very attractive for the risks implied compared to other regions such as US IG, with almost 100 bps spread pick-up in the case of LATAM IG, for instance. It is worth highlighting that we maintain our OW in LATAM as we continue seeing solid fundamentals and very attractive valuations on a relatively basis vs other EM regions.
- On the other hand, recent movements in local currency debt could open up opportunities and we focus on LatAm, South Africa and India. Overall, EM growth and a stable policy backdrop are positive for EM assets, including hard currency debt. We are monitoring the political environment in Turkey, but do not see insolvency risks. Country selection is essential amid the geopolitical tensions over China and the United States.

ESG Metrics

- At the end of Q1, the overall **ESG Quality Score** of the portfolio was 44% higher than the index, standing at 7.6 (equivalent to an MSCI ESG Rating of AA) vs. 5.3 for the index (equivalent to an MSCI ESG Rating of BBB)

  Source: @2023 MSCI ESG Research LLC - coverage: 96% for the fund and 88% for the index.

KEY INDICATORS

- The **weighted average carbon intensity**[1] of the fund is 45% below its index, at 346 tons CO2e/$M sales revenues v. 633 tons CO2e/$M sales revenues for the index.

  Source: @2023 MSCI ESG Research – coverage by number of issuers: 90% for the fund and 91% for the index.

- According to ISS, scope 1,2, and 3 greenhouse gas emissions stand at 16.5% below those of the JP Morgan CEMBI Diversified Index. The Carbon Intensity of the portfolio is 70% better than that of the universe.

  Source: ISS – coverage by number of issuers: 96% for the fund and 86% for the index.

- 49% of the electricity generated from our holdings in the utilities sector come from green power, compared to only 13% in the index.

  Source: ISS – coverage by number of issuers: 96% for the fund and 86% for the index.

- **International norms**:
  - Violation of UN Global Compact: 0% (vs. 1.2% in the index)
  - Violation of Human Rights norms: 0% (vs. 1.2% in the index)
  - Violation of Labour norms: 0% (vs. 0.8% in the index)

  Source: @2023 MSCI ESG Research - coverage level: 90% for the fund and 89% for the index

- **Board Independence**: 85.1% of the portfolio is invested in companies that have a majority of independent board members, vs 74.2% for the index.

  Source: @2023 MSCI ESG Research - coverage level: 90% for the fund and 86% for the index

- **Board Diversity:** 90.4% of the portfolio is invested in companies that have at least one female Director, vs 86.6% for the index.

  Source: @2023 MSCI ESG Research - coverage level: 90% for the fund and 86% for the index

- The average **Fatality** rate stands at 0.9 per 100,000 employees in the fund compared to 2.0 per 100,000 employees in the index. (Source: MSCI ESG Research – coverage 33.8% of issuers in the fund vs. 26.3% of issuers in the index – the coverage ratio depends on the materiality of the indicator).

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