UBAM – GLOBAL TECH 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

- Reflationary pressures and cyclical rotations dominated markets' news flow in Q1, in the wake of a broad acceleration in the covid-19 vaccination campaigns rollout and the prospect of massive stimulus in the US.
- Altogether, these factors triggered a sharp rise in long-term rates (10-year US Treasury yields up +80bps q/q) and sector performance dispersion, to the detriment of 2020's biggest "winners" (tech and growth). The S&P 500 Growth Index underperformed the S&P 500 Value Index by 865bps q/q and the S&P 500 Information Technology index underperformed the broad S&P 500 index by 419bps q/q.
- After a strong start into the year, the cyclical rotation weighted down on the performance of convertible bonds. This is explained by the large share of higher growth companies in the asset class' universe and the high volatility exhibited by the tech sector during the period: specifically, 6 weeks of outperformance followed by 6 weeks of underperformance.
- Global convertible bond issuance totaled north of USD 62 billion in Q1, wrapping up the best start to a year on record. The vast majority came from the US (USD 44bn). Looking at the US tech segment specifically, 18 new convertible bond deals were issued in Q1 and entered our investment universe, for a total amount of USD 10.1 billion.

Performance Review

- **UBAM – Global Tech Convertible Bond was launched on February 4th**. From February 4th to March 31st, the strategy condeded 9.0%, in line with its investment univers (-8.9% for the ICE BofA US Tech Convertible Bond index USD[1]) though exhibiting lower volatility and drawdown.
- The performance of the strategy over the period should be put in perspective with both the behaviour of the tech theme, and its implementation within the convertible bond space. The combination of a deep cyclical rotation and a sharp increase in long-term interest rates caused a noticeable underperformance of the tech theme, both in absolute and relative terms compared to the broad equity market. In the tech convertible bond space, the detracting effects of the cyclical rotation were further exacerbated by two factors: 1) first and foremost, the predominance of mid-cap companies, which were more severely hit amidst the tech sell-off; 2) a flurry of new tech convertible bond deals (more than 10% of the universe), which added to the downward pressure on valuations.
- On the implementation front, it is worth noting that we were able to invest inflows as they arrived at an overall limited cost (17bps). Our approach, focused on outlier-mitigation, helped reduce the universe's overall volatility and drawdown.
- At single name level, the counter-performance (in absolute terms) of tech convertible bonds since the launch of the strategy was concentrated in software companies (e.g. Microstrategy, MongoDB, Coupa) while semiconductors held up well (e.g. Synaptics, Microchip Technology), on the back of positive news flow and promising pipeline.
- Taking a step back from the ultra-short-term though, US tech convertible bonds[1] captured no less than 100% of US tech equities[2]' performance over the past year (+11% vs. the S&P 500) with lower annualised volatility of 22% vs. 28%.

[1]For indicative purpose only, the strategy has no official benchmark. [2]Tech Select Sector Index (USD).

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

- UBAM – Global Tech Convertible Bond was launched during the course of the quarter, on February 4th. Day one, the portfolio was 95% invested and the investment level remained above that level throughout the period.
- We took advantage of booming primary activity in the tech convertible space, both in terms of number of issues and outstanding amounts, to gradually add new names as they entered our universe (e.g. Dropbox, Fastly, Tyler Technology). We were also active in the secondary market thanks to complacent liquidity levels (e.g. Enphase Energy, Everbridge).
- Applying our liquidity and convexity-focused quantitative allocation approach
  - we notably trimmed our investments in Coupa Software and Palo Alto Network, due to their relatively higher contribution to risk;
  - we sold our positions in Microchip 2037 and Nice 2024, on liquidity basis;
  - we maintained an under exposure to Square – the largest weight in the tech convertible bond space (ex. mandatories) – on accounting criteria.

Outlook

- Besides recent weaknesses, the case for tech convertible bonds remains strong.
- The convex nature of convertible bonds makes them compelling assets for those who wish to maintain, or reinitiate, an equity exposure to the tech sector whilst keeping their investment's volatility into contained ranges – as repeatedly demonstrated historically, and again over the past year.
- Though damaging in the very short term, the recent correction has opened an attractive entry point into the tech convertible bond space with more attractive valuations, translating into even greater convexity potential.
- Generally speaking, the recent cyclical rotation does not question the long-term case for the tech industry. If anything, the pandemic has accelerated the spread of trends that were already in place before the covid-19 outbreak (digital transformation to improve business efficiency; cybersecurity to secure an ever-increasing number of online transactions; healthcare innovation to deal with the growing and ageing global population; etc.) and for which the long-term fundamentals remain unchanged.
- Over the past fifteen months, and even more so in February and March, convertible bonds' record issuance dynamism has sparked a broad deepening and renewal of the investment pool with the tech industry as spearhead. In the very short term, such exceptional volumes came at a cost, weighting down on valuations at a time where the tech convertible bond market was under cyclical rotation pressures. Looking ahead though, they open massive opportunities. These notably include greater liquidity and diversification opportunities, with the arrival of new tech companies into our universe next to repeat and well-known issuers.
- At the portfolio level, despite recent moves, we stick to our target to reduce significantly (by up to 25%) the volatility of tech equities over the long run, with an observed beta between 0.45 and 0.50.

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