THE DRIVE YOU DEMAND

UBAM - MULTIFUNDS ALTERNATIVE

Quarterly Comment | Q4 2018

For Qualified Investors in Switzerland or Professional Investors or Eligible Counterparties as defined by the relevant laws.

Markets

- Global equity markets were down -13.42% during the fourth quarter, bringing the YTD performance to -8.71%, as measured by the MSCI Daily TR Net World Index. The final quarter of 2018 was not good for equity markets. Investors had to contend with rising US central bank interest rates, a sharp slowdown in Eurozone business confidence, weaker Chinese growth and rising geopolitical concerns (including Brexit, Italian politics and the ongoing trade conflict between the US and China). This all proved an indigestible cocktail for investors. The biggest challenge for markets is that global growth is slowing at the same time as the Central Banks are winding down quantitative easing.
- In contrast to the first three quarters of 2018, Developed Markets underperformed global markets in Q4. In the US, markets were dominated by fears of further rate hikes and that the US is late in its economic cycle, driving the S&P 500 down by -13.97%. The MSCI Europe declined by -11.32% over the quarter, with all underlying county indices being down meaningfully. The Nikkei 225 also saw a strong decline (-17.02%).
- Emerging Market (EM) equities also declined meaningfully in Q4 but did relatively better than Developed Markets, the MSCI EM being down -7.47% in Q4. The prospects of a Chinese stimulus and a slower pace of interest rates hikes in the US, as well as lower equity valuation were supportive factors. On a YTD basis, Emerging Markets still underperformed Developed markets, on aggregate, with the MSCI Emerging Markets being down -14.58% in 2018.
- In light of the market sell off, volatility increased sharply during this fourth quarter, closing the year much higher than in 2017. The regime change that we started to witness in February continues to be valid, as markets seem more focused on fears like slower growth, trade tensions or higher interest rates. The VIX closed Q4 at around 25, versus close to 12 at the end of Q3.
- After rising during most of 2018, US and European bond yields decreased in Q4. After initially moving higher in the first part of the quarter, yields sharply reversed from mid-November as increased geopolitical tensions and question marks about the strength of the global economy drove equities lower, with investors selling equities and buying treasuries, in a classic risk-off trade. Monetary policy continues to tighten, although the Fed has lately been more dovish than during most of the year.
- An increased market and interest rates volatility should provide a fertile ground for UBAM - Multifunds Alternative. The Absolute Return characteristics of the portfolio, which combines mainly alpha drivers, traders and to a lesser extent, fundamental value managers, typically benefits from more volatile environments. As traditional bond investors look for alternatives strategies, we believe that UBAM - Multifunds Alternative provides diversification through uncorrelated return drivers, limited beta and volatility, as well as controlled drawdowns.

Performance Review

- During the fourth quarter, UBAM - Multifunds Alternative (Class IC USD) lost -3.06%, taking the YTD performance to -3.10% (all reported net of fees). The UCITS Alternative Fund of Funds Index dropped by -4.53% during Q4, bringing its YTD performance to -6.18%. UBAM - Multifunds Alternative outperformed its benchmark by 308bps in 2018.
- All main strategies apart from Event Driven had a negative contribution during the quarter. Long/Short Equity, Commodities and Macro/CTA contributed -233bps, -41bps and -25bps respectively, while the Event Driven exposure added +15bps to the portfolio (all expressed in gross terms). The bulk of the losses in the Long/Short Equity bucket can be attributed to the Fundamental Moderate Net strategies, where our L/S Equity manager focusing on Biotechnology & Healthcare was down -22.15% for the quarter. This fund was impacted by the extreme drawdown of the Nasdaq Biotechnology Index and the Health Care Select Sector SPDR during Q4, which lost -20.92% and -9.08% respectively. In addition, Quantitative L/S Equity Market Neutral managers suffered from the deleveraging and steep sell-off in high growth/momentum sectors, such as Technology and Cyclicals.
- Looking at the underlying fund level, the top performer over Q4 was our Event Driven manager focusing on Merger & Mixed Arbitrage situations, who added +15bps to the portfolio's performance. In a very volatile and treacherous equity environment, the manager purposefully reduced the leverage of the Fund to take into account the new riskier environment. The portfolio's Merger Arbitrage allocation was tactically cut to reduce the portfolio's sensitivity to the equity drawdown observed during Q4; this move was also made to the benefit of the portfolio's Mixed Arbitrage component, a decision which proved successful when the markets became choppy. It should be noted that Mixed Arbitrage tends to act as a portfolio buffer during stressed market conditions, as the underlying positions within this bucket seek to exploit arbitrage opportunities that take no market directionality. From a purely bottom-up standpoint, the recent positive developments on a few merger transactions such as Fox / Disney, Rockwell Collins / United Technologies, and Aetna / CVS Health generated positive performance to the Fund.
- On the negative side, the three largest detractors were one L/S Equity manager focusing on Biotechnology & Healthcare (as previously mentioned), an European L/S Equity Quantitative manager and one Commodity manager focusing on oil. Our Commodity manager came into Q4 with a significant long exposure to oil. After the price of oil collapsed in October, he cut exposure and despite remaining long, was able to limit further losses. As mentioned above, the L/S Equity manager focusing on Biotechnology & Healthcare was the largest detractor, impacting most of the overall portfolio. In line with the broad decline seen in equity markets, the recent three-month period has been one of the worst on record for therapeutic stocks. The current environment dominated by concerns on slowing global growth, the US-China trade war and a hawkish US Federal Reserve has created exaggerated moves across the board in that segment, where the theme has been "good news gets sold, bad news gets punished." This has been true not only for higher-beta stocks that would normally feel the brunt of a risk-off environment, but also for large and mega-cap therapeutics, stocks generally thought to be more stable and beneficiaries of a flight to safety.

Portfolio Activity

- UBAM - Multifunds Alternative is a weekly UCITS FoF investing in 10 to 20 uncorrelated, high conviction alternative managers from UBP's Approved List. It aims to be an Absolute Return portfolio acting as an alternative and/or complement to traditional fixed income investments. Its objective is to generate attractive risk-adjusted returns with low directional market exposure (low equity beta). The focus is on managers who have consistently generated alpha in different market environments. The portfolio is built around three main return drivers in order to deliver uncorrelated returns versus financial markets: (1) Alpha Drivers with a moderate to neutral equity market exposure, such as Relative Value and Long/Short Equity Market Neutral strategies; (2) Trading managers with high trading skills, such as Discretionary Global Macro, Commodity and Long/Short Equity with a trading bias; and (3) Fundamental Value managers seeking to exploit valuation opportunities.
- Four managers were fully redeemed from the portfolio and one new manager was introduced during the quarter. A Discretionary Global Macro fund focusing on Emerging Markets and a Systematic Trend Follower (CTA) were both exited due to disappointing performance. In addition, we have tactically reduced exposure to Emerging Market equities and lowered equity beta by fully redeeming two additional Long/Short Equity managers (one focusing on Frontier Emerging Markets and the other on the Asia/Pacific region). The proceeds were re-allocated into our highest conviction managers within low net Equity and Quantitative Market Neutral strategies. We have also introduced a new fundamental Global Long/Short Equity manager applying a rigorous bottom-up analysis; the strategy is applied across a relatively concentrated book, which usually runs a 50-75% net long exposure and a 120-160% gross exposure.
- Strategy wise, the Long/Short Equity allocation was decreased from 56% to 53%. This decrease was mainly directed towards reducing exposure to Emerging Market equities. The Macro book was stable at approximately 35%. We reduced exposure to thematic Global Macro (which tends to be more directional in nature) and increased exposure to more Relative Value focused Global Macro managers. Event Driven strategies were increased from 6 to 8%, focusing on Merger & Mixed Arbitrage strategies. Commodity exposure was slightly reduced from 3% to 2%, in line with the increased volatility in the oil sector.
- UBAM - Multifunds Alternative is a high conviction and relatively concentrated portfolio. During the quarter, the number of underlying positions dropped from 17 to 13. Over Q4, the weight of the portfolio's top 10 positions increased from 76% to 89%; from a risk attribution perspective, these top 10 positions represent 92% of the portfolio's overall risk profile.
- The portfolio's equity beta remained fairly stable throughout the quarter at about 0.14.

Outlook & Positioning

- In terms of positioning and as just mentioned, UBAM - Multifunds Alternative has become more concentrated in high conviction names. The Absolute Return profile aiming at getting a limited correlation to equity markets remains the same. We continue to expect increased volatility, a rising interest rate environment, and greater dispersion in financial markets. As a result, the portfolio should continue to be run with modest market directionality.

- Within Long/Short Equity, we believe 2019 could be a strong year for stock picking alpha, even if equity markets move lower or sideways in a volatile fashion. As such, we favour low net Absolute Return strategies, which could potentially generate attractive returns – even when equity markets decline – over long-biased funds.
- Within Global Macro, the current environment should continue to favour Relative Value over Directional strategies. We continue to have a preference for actively traded and relative value biased strategies over concentrated medium-term thematic approaches. Relative Value strategies should prosper in an environment in which volatility is rising, liquidity is tightening and interest rates are going up.
- M&A cycles are long and we are currently midway through the current one's life span. We should see more deals being announced and spreads should widen in the short-term, offering more attractive returns given the lack of capital at work in the strategy at the moment. We shall continue to see transactions in the real-estate, healthcare and insurance sectors. Based on the investment team's conversations with industry participants, a significant pick-up in TMT deals could also be observed.
- Finally, Systematic Equity managers shall continue to offer alternative, liquid, risk-adjusted return streams via efficient, diversified, active, largely market-neutral portfolios in a late cycle market environment, which is otherwise challenging for fundamental, concentrated, and directional managers.