Q1 2023

UBAM – EUROPEAN 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

- While January benefited from a strong risk on momentum, the trend has started to reverse in February after higher than expected inflation numbers and central banks' officials' comments. In the beginning of March markets moved into a risk-off mode on the back of Silicon Valley Bank failure and the loss of confidence crisis impacting Credit Suisse. Interest rate volatility moved to a level lastly saw in 2008 before falling back. Central banks have continued to raise their respective policy rates despite these events in the banking sector The Fed and the ECB rose their policy rates by 25bps and 50bps respectively. Their main focus is still inflation which hasn't fallen enough. They reiterated that future decisions regarding their policy will be data driven, therefore economic data release will be key in the coming adjustments. Despite a tumultuous month of March, risky asset ended the quarter higher. However, with renewed recession risk, the long end of yield curves have fallen, the US and German 10-year rate fell by 41bps and 28bps to 3.46% and to 2.29% over the quarter respectively. European credit spreads tightened for HY by 20bps while there were stable for IG by the end of March.
- Despite the volatility over the month of March, major equity markets still delivered positive performances over the first quarter of the year and global equities ended the quarter up 6.9% (MSCI World TR hedged in euros). In Europe, the Stoxx Europe 600 index was up 10.5% q/q. In terms of investment styles, the "Growth" play outperformed the "Value" overall, as revealed by the MSCI Europe Growth index up 11.6% q/q, 5.8% ahead of the Growth index.
- Being up 3.7%, European convertible bonds exhibited a satisfying behavior showing its capacity to both rally when market environment improves and to mitigate downside risk.
- Primary market confirmed the rebound seen the last quarter of 2022 as global markets introduced close to $20 billion of convertible bonds during the first quarter of 2023. The US contributing $12.9bn, Europe $4.7bn and Asia $1.8bn and Japan $0.3bn. In Europe, issuances have been dominated by Industrials companies.

Performance Review

- In Q1, the UBAM – European Convertible Bond increased by 2.3% after fees (IC EUR share class), slightly behind its index, the Refinitiv Europe Hedged Convertible Bond index (EUR), by -1.4%.
- The main contributing sectors were Information Technology (+138bps), Financials (+53bps) and Consumer Discretionary (+45bps), while Utilities (-10bps) and Health Care (-51bps) detracted to the overall fund performance. At issuer level, top contributors over the quarter include STMicroelectronics (+75bps), Cellnex (+41bps) and Amadeus (+41bps). Conversely, our investments in Ubisoft (-20bps), Qiagen (-25bps) and Diasorin (-34bps) hurt performance. Relative to the index, main contributors are BE semicondutor (+35bps, overweight), LVMH (+28bps, overweight), and Accor (+26bps, overweight), while main detractors include Airfrance (-19bps, not in our portfolio), IAG (-22bps, not in our portfolio) and our exposure to Diasorin (-25bps, overweight).

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 – European Convertible Bond stands at 38% (+8pts q/q), +3pts above the index's. The strategy's interest rate sensitivity is very much contained at 1.7 for a 2.9-year duration. Lastly, the portfolio exhibits an average credit spread of 173bps (+4bps q/q) vs. 274bps for the index – levels that reflect the "quality" bias inherent to our security selection process.
- From a sector standpoint, the sub-fund is primarily exposed to equity markets through investments in Consumer Discretionary (8.9%), Industrials (7.0%) and Communication Services (5.0%). Despsite being in our lagest sector exposure, we actually are underweight in Industrials and Communication services when compared to the index. Vs. th eindex we are overweight in Technology and Financials.
- Supported by a busy primary market we initiated several new positions that are in line with our Quality positioning. We participated in a first-time issue from Spie in the convertible bond market, with a convert offering a 2.0% coupon and 2028 maturity. This is a good example of issuer leveraging on the lower cost of debt when issuing convertible bonds when compared to straight bonds. We initiated new positions in two exchangeable convertible bonds: Wendel into Bureau Veritas 2.625% 2027 and FEMSA in Heineken 2.625% 2026. In the semi-conductor space, we sold STMicroelectronics 2025 to buy 2027 issue on the back of the upcoming call on the convertible bond with the shorter maturity.

Outlook

- The January outperformance from low-quality names was pricing excessive optimism and was not justified by the current economic environment. In the foreseeable future inflation should stay above central bank target and higher than experienced in the previous decade. Although economic data suggests that the overall slowdown could be smaller than previously anticipated, 2023 is still likely to be a challenging year for corporates. However, with global inflation pressure easing and rate hikes slowing, the factors holding back consumer demand and corporate earnings should fade throughout the year. That being said we still expect dispersion to be particularly high in the equity markets and we believe Quality is the right place to be invested thanks to intrinsic characteristics: Pricing power, healthy balance sheet, robust business models and clear visibility in earnings growth.
- Recent market events have been a good reminder that uncertainty is still very high, and that markets are fragile. In this context convertible bonds constitute an attractive way to maintain equity exposure whilst containing overall volatility. Especially after last year's reset, convertibles bonds with renewed profiles (convertible bonds moved towards "bond-like" providing better downside protection) have the potential to deliver strong risk-adjusted returns over the medium-term.
- Furthermore, European convertible bond issuers' valuations look attractive: the median Price-to-Sales Ratio for convertible bonds issuers is 46% lower than its 2021 high.
- After being negative for a while, yield in the convertible universe has now moved into positive territory and average yield for European convertible bonds is back to 2011-2012 levels. Close to 50% of the convertible bond universe offers a yield between 2% and 10%. This constitutes a return driver that has been missing for a several years.
- Convertible bonds underlying equities are not expensive anymore and yield is back in the convertible bond universe. As a result, the outlook for convertible bonds is positive thanks to restored multiple performance drivers: underlying equity upside potential, yields and credit.

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