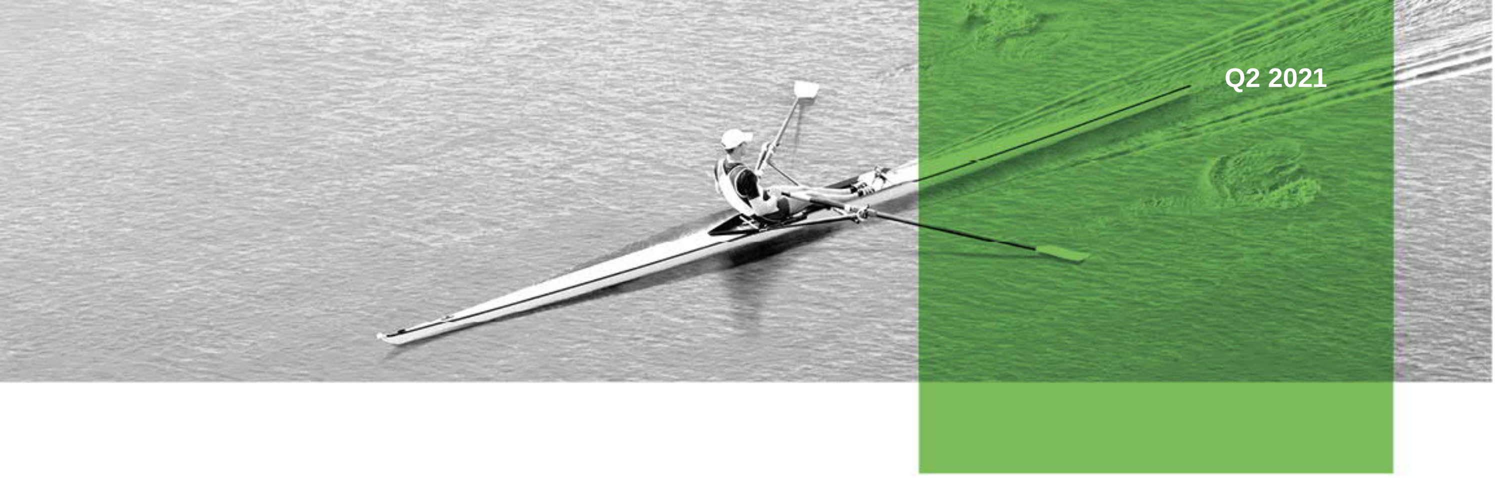


UBAM – best selection China A

Quarterly Comment | Q2 2021

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

Market Comment

- Market preferences remain unchanged in the second quarter. The herd mentality was gone, and the focus came to the small-and-mid-cap stocks. However, this type of extreme style rotation may not last long, simply because the assets, whether it's domestic money or foreign capital, will be invested in the highly liquid CSI 300 Index.
- In May, the market shift was obvious. Purchases were mainly focused on small-and-mid-cap stocks. Growth stocks that have been growing for the last three years were no longer favored. Foreign institutional investors will undoubtedly focus on the CSI 300 Index which is a combination made up of the best companies in China. Meanwhile, the CSI 300 Index was related to the GDP growth in the long run.
- The market fluctuated in June. Small-and-mid-cap stocks were still on the rise till recently. The price of blue-chip indices remained little changed while SME and ChiNext Index showed strong performance. Judging by the volatility pattern and the macro economy, we estimate that there will be a surge in the coming months.
- During the June quarter, Asia equity market seems rather smooth or even quiet on the surface as it marked +3% gain. But it was macro heavy, news sensitive, sentiment driven, volatile market. As investors digest the US inflation will be transitory, 10-year treasury yield gradually came off, but the tapering concern didn't go away easily. Therefore, short-lived reflation trades including financials, cyclicals, and materials moved aggressively to both up and downsides. Reopening expectation and macro concerns squared each other; market was eventually flat.
- It was a consensus that Biden administration won't turn China relationship better soon and now we can comfortably confirm consensus is correct. Moreover, clamping down Chinese internet giants by government added more fuel to the fire. And PBoC's hawkish stance didn't help much on China's performance last quarter.
- We continue to like global recovery beneficiaries, Korea, Taiwan, Hong Kong and Singapore in 2H and we are cautious on China and ASEAN. During the second quarter, we have changed our stance on India to negative and back to neutral when the covid-19 cases went up. We were not worried about the muted activity since this could be a short term but we were worried about India's political environment as PM Narendra Modi's approval rate hit historical low. India managed to control the virus much sooner than expected and Modi's popularity followed as well, hence we have narrowed underweight position accordingly.

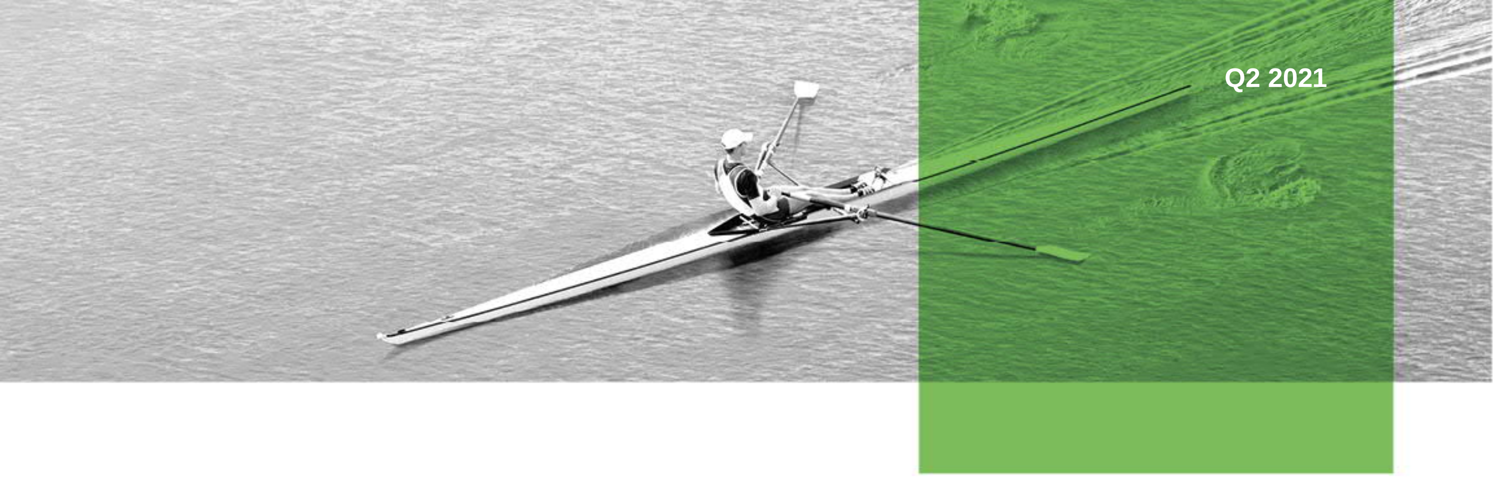
Sources: UBP, Bloomberg Finance LP.

Performance Review

- During the second quarter, the strategy outperformed the MSCI China A NR. Sector allocation contributed, but stock selection detracted.
- After a strong year in 2020 which saw a very good year for China A and for the strategy. The market has become slightly more volatile during the first and second quarter of 2021, with an acceleration in June 2021.
- Data shows the drop of implied volatility may end soon, so the excessive return of small-and-mid-cap stocks may come to an end. At the same time, the increase of blue-chip volatility was getting smaller, so we increased position of blue-chip stocks to form a balanced portfolio.
- The option market and our volatility model are key sources to construct volatility surface. Chinese market's option-based derivatives have been developed rapidly in recent years, providing us more local listed options as well as OTC single stock options. Our in-house AI model has been developed to provide us with the calculation future volatility of options and equities, and it has been improving all the time with more option contract issued.

Portfolio Activity

- Like in the first quarter of 2021, during the second quarter we maintained the same number of stocks in the portfolio. The equity allocation did not change drastically during the quarter and was kept above 90%. The position was little changed because the volatility was low, but also because we wanted to keep a low turnover rate.



Outlook

- The 100th birthday of the Communist Party and the PBOC cutting reserve ratio on June 8 is likely to inspire an upward trend in the market. Therefore, we have a positive outlook for the market, with blue chips leading the trend. We estimate there are opportunities in the market, whether they are coming from the structural changes or market style rotations, and we will stick to our strategy of picking low-volatility stocks and realize long-term compound interest for our investors
- Strong economic data and the momentum of the recovery have been a key driver of equity markets this quarter and with no doubt shall provide continued support. This was evident in the exceptionally strong March quarter reporting period, which saw the average earnings result beat expectations by over 20%. The stellar performance of the market since the drawdown in March 2020 has seen the MSCI World Index rally 93% in USD.
- The global economy is expected to rebound sharply this year thanks notably to the large support packages that many countries have pledged. The rebound in some EM countries may, however, be slower than initially planned due to the delayed deployment of vaccines and the appearance of new Covid-19 variants.
- A strong recovery is expected in Q3, but mainly driven by the rebound in domestic demand in developed countries. With the reopening of the economy, demand surged for goods and services after a long lockdown. US consumers spent the direct support delivered by the US Administration in Q1, but they still have large excess savings. In Europe, a similar rebound is underway from Q2 onwards, as governments prevented a large rise in unemployment and protected household incomes. Confidence is increasing further. GDP is expected to accelerate from the reopening phase thanks to a surge in domestic demand. US, UK and European growth should be close to double-digits in H2-21. Consumption and investment should benefit from deployment of the recovery plans adopted in the EU and discussed in the US, but emergency help to sectors and labour will end with reopening economies.
- Central banks will show more divergent strategies; some will shift their communication in favor of a more neutral stance, preparing markets to a tapering next year. Some central banks have mentioned their willingness to taper or adjust rates in the future: Canada, New-Zealand, Korea, Sweden and the UK's BoE have moderated their bond purchases. The Fed should explicitly talk about tapering in Q3 and prepare markets to reduce its purchases in 2022. To the contrary, the ECB should continue to purchase bonds in 2022 as inflation should be back below 2%.

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