Q2 2020

UBAM – EM INVESTMENT GRADE CORPORATE BOND

Quarterly Comment

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

Market Comment

- After the sharp collapse in risk assets in March, triggered by the COVID-19 pandemic, the second quarter of the year saw a strong rally. This was supported by the series of massive monetary and fiscal packages put in place by DM and EM central banks and government authorities to cushion the effects of the lockdowns on the world economy. Indeed, while these measures will not prevent a global recession, estimated at -4.9% by the IMF, market participants saw them as a sign that a worse outcome would be avoided.
- Also, as the quarter advanced, there were signs that the pandemic was receding, with lockdowns being gradually eased in several countries, which led to a pick-up in economic activity, notably in China.
- US treasury yields continued to come down on the back of quantitative easing, but with much reduced volatility: 2-year US Treasury rates were down by -10 bps to 0.15% while 10-year rates fell by -1 bps to 0.66%.
- Commodities rebounded, with the CRB index up by over 13%. Oil prices had their best quarter in 30 years after the OPEC+ finally reached an agreement to cut production by 9.7 million barrels per day starting May 1 – agreement which was extended early June to the month of July (-9.6 bbl/day). Some weakness late June was felt as new cases of the virus appeared in some countries, raising fears that this could trigger a return of lockdowns. But this was compensated by a reduction in US crude stockpiles later in the month. Overall, Brent prices jumped by 81%, ending the quarter over $41/bbl, while WTI almost doubled to $39/bbl. Metal prices also shot up, with silver and iron ore rising by 30%, copper +22% and gold +13%.
- In EM bond markets, this better tone helped liquidity to come back gradually, outflows to stop and the primary market to reopen.
- Overall, EM corporate Investment Grade bonds rose by 9.0%, with spreads down by 108 bps to 289 bps.
- At a regional level, the best performance came from Africa (+18.9%) and Latin America (+14.1%). In contrast, Asia (+5.7%) and Europe (+6.9%) underperformed.

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.

- At a country level, the best performance came from South Africa (+34.5%), Chile (+15.3%) and Brazil (+15.1%). In contrast, safer issuers from Taiwan (+2.4%), Poland (+2.5%), China (+3.4%), Hong Kong (+3.8%) and Korea (+3.8%) – countries which had held well through the sell-off, underperformed.
- At a sector level, the best performance came from Pulp & Paper (+18.9%), which was the worst performing sector in Q1. Infrastructure (+15.2%) and Consumer (+13.8%) also performed well. In contrast, Diversified companies (+3.4%), Real Estate (+5.8%) and Financials (+6.4%) underperformed.

Performance Review

- Over the quarter, the fund returned 8.74% net of fees and 8.96% gross of fees, compared to 9.00% for the JP Morgan CEMBI Diversified High Grade Index*.
- Performance attribution shows that the fund outperformed by 38 bps, but prinig differences, reflecting still high bid-offer spreads (even if less so than in the previous quarter) representend 42 bps.
- The fund benefited from its credit selection (carry spread and spread effect +45 bps), while duration and curve positionning were marginally negative (-6 bps).
- Main contributors to relative performance, excluding the effect of our interest rate duration/curve positioning which is managed at portfolio level:
    - Country-wise, the best performance came from our overweight and selection in Mexico and India, as well as from our underweight and selection in Thailand. In contrast, our selection in Chile , underweight in Colombia and selection in Qatar proved costly.
    - Sector-wise, the fund benefited from its underweight in Financials, as well as selection in Utilities and Consumer companies. In contrast the fund suffered from its selection in Metals & Mining and in Telecom.

**Index provided for comparison and information purposes only. The fund has no official benchmark.*

Portfolio Activity

- Over the quarter, our scorecard pointed gradually towards a more positive environment, as volatility fell across market and risk appetite returned. We thus increased our spread duration but remained neutral interest rate duration.
- We sold some protection through CDX indices (Asia ex Japan IG) to increase our market exposure efficiently and at low cost, thanks to much tighter bid-offer spreads than in cash bonds.
- We increased holdings in Asian and European issuers which lagged in the rally at the expense primarily of the Middle East.
- In Asia, we favoured China (TMT, Consumer companies), India (Oil & Gas, Utilities) and Hong Kong (TMT) at the expense of Korea (Metals & Mining) and Taiwan (TMT).
- In Europe, we added to our holdings in Russia (Oil & Gas, Metals & Mining).
- In Latin America, we reduced our holdings in Brazil (Pulp & Paper) in favour of Chile (Utilities, Financials) and Mexico (Consumer).

- In the Middle East and Africa, we reduced holdings in Kuwait (Diversified) and Qatar (Financials) in favour of Saudi Arabia (Oil & Gas) and South Africa (Metals & Mining).
- At a sector level, we added holdings in TMT, Utilities, Oil & Gas and Metals & Mining. In contrast, we reduced our positions in Financials, Diversified companies and Industrials.

Outlook

- Volatility has come down and liquidity has improved but the impact of the pandemic-induced lockdowns on global growth is sharper than initially expected. Over the medium-term, we see as a positive the forceful reaction of public authorities around the world. Many EM central banks have decided to cut rates while some governments have also announced fiscal measures. The US Federal Reserve's Quantitative Easing will put pressure on the US Dollar, which in turn will continue to reflate financial assets and commodities.
- While the world is entering a global recession, EM economies are expected to fare better than DM thanks to the earlier rebound of Asia, as well as to the vast diversity of EM economies. We thus expect the gap in economic activity between EM and DM to widen again, which should contribute to attract further capital flows towards EM.
- Already, inflows into EM corporate bonds have picked up again and supported the better tone in the market experienced since early April. Primary markets have reopened allowing many sovereign and corporate issuers, both IG and HY, to refinance.
- Still, the economic slowdown has a negative impact on issuers creditworthiness, leading to a rise in the number of rating downgrades and for some even, default. Issuer selection remains thus of paramount importance, so we are relying on our credit analysts to avoid negative credit events, with special focus on:
    - Issuers' capacity to generate operating cashflows and maintain a good level of activity, and keep adequate liquidity
    - Their capacity to refinance
    - Their ability to support the leverage accumulated during the crisis
    - Valuations to identify attractive opportunities (overly penalised issuers)

- At a country level, our largest overweight positions are in India, China, South Africa and Russia.
- Our largest underweights are in Saudi Arabia, Qatar, Singapore and Kuwait.
- At a sector level, our largest overweight positions are in Metals & Mining, Industrials and Infrastructure. Our largest underweights are in Financials, Oil & Gas, and the Consumer sector.

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