Q1 2021

UBAM – GLOBAL 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 Treasury yields up +80bps q/q in the US, +28bps q/q in the Eurozone) and noticeable sector performance dispersion on equity markets to the detriment of 2020’s biggest “winners” (tech and growth). After a strong start into the year, the cyclical rotation weighted down on the performance of convertible bonds, due to the large share of higher growth companies in the asset class’ universe.
- Region-wise, on global equity markets, the outperformance of value and cyclical names largely benefited European stocks which posted strong gains in Q1. The Stoxx Europe 600 index closed the quarter up 7.4%, +1.5% ahead of the S&P 500 index and +1.4% ahead of the MSCI World index (all indices hedged into euro). In Asia, the Nikkei 225 index closed the quarter up 6.3% (local currency).
- Global convertible bond issuance totalled over USD 62 billion in Q1, wrapping up the best start to a year on record. The vast majority came from the US (USD 44bn) followed by Europe (USD 10.5bn). Looking into details, Q1 new issues were primarily driven by companies in the tech, consumer discretionary, communication and healthcare industries.

Performance Review

- UBAM - Global Convertible Bond conceded 0.39% in Q1 (after fees, IC EUR share class). Over the same period, the Refinitiv Global Hedged Convertible Bond (EUR) (“the index”) progressed by 1.70%.
- The performance of the strategy during the quarter should be put in perspective with the cyclical rotation that has dominated global equity markets for the past five months. The « growth » bias of the convertible bond market was a clear performance engine last year, both in absolute and relative terms. With the ongoing rotation though, it is this very same bias that explains the recent lag of the asset class when compared to equity indices. At the strategy level, the impacts of the rotation were further exacerbated by the quality-growth focus at the very heart of our process, and therefore structural underweight to those sectors and names that benefited the most from the recent value and cyclical bull run.
- Thus, in sharp contrast with 2020, the Communication and Technology sectors were the largest detractors to the strategy’s absolute performance in Q1. Looking into details, this is explained by the counter-performance, during that period, of names such as MongoDB (US, Tech), Pinduoduo (Asia, Communications) or Coupa Software (US, Tech). On the opposite-end, our investments in Financials (e.g. CG Services and PSBC in Asia), Consumer Cyclical (e.g. Southwest Airlines and Live Nation Entertainment in the US) and Industrials (e.g. Airbus in Europe) proved the most beneficial. Region-wise, our investments in Asia concentrated the gains when the European and US buckets had negative contributions overall.
- Taking a step back from the very short-term, our global flagship strategy has managed to capture 73% of global equities[1]’ performance (after fees) over the past year with half their annualised volatility (13% vs. 28%) and a balanced average equity sensitivity of 53%.

[1] MSCI World Net Total Return (hedged euro).

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

- During the quarter, the average equity sensitivity of the portfolio increased by 3pts, up to 57% at March-end, with the following regional split: US 39% (+5% q/q), Europe 13% (-2% q/q), Asia & Japan 5% (flat q/q).
- The strategy's interest rate sensitivity remained contained and in line with its historical average level, at 1.6 for a 4-year duration. In terms of credit quality, as of March 31st, the portfolio exhibits an average credit spread of 225bps (-11bps q/q) which compares to 294bps for the index. These levels reflect the "quality" bias inherent to our philosophy.
- With the overall sharp outperformance of the digital theme in 2020, our convexity-focused approach, combined with our wish to maintain a sound diversification in our portfolios, had led us to early take profits on our biggest "covid-winner" holdings, to the benefit of companies offering balanced convertible bond instruments including in the "covid-recovery" theme. We continued that process in Q1, focusing strictly on companies with robust balance sheet according to our analysis, and leading competitive positioning (e.g. Airbnb, Southwest Airlines, Booking.com and Expedia in the US; Safran in Europe…). Besides, we took advantage of recent weaknesses in the growth segment to selectively strengthen some of our conviction names under more favorable pricing terms.

Outlook

- Besides the recent cyclical rotation, the case for convertible bonds remains strong. The convex nature of convertible bonds makes them compelling assets for those who wish to maintain an equity exposure whilst dialling back their risk a bit. In a context of near-record equity prices, elevated single stock volatility and lack of visibility as to when, and how fast, economies will reopen, an asymmetric equity exposure appears as a valid alternative to a full directional positioning. Convertible bonds' appeal is equally strong in a rising interest rates environment for those who wish to maintain bond-floor defensive features: thanks to their conversion option, convertible bonds embed much lower interest rate sensitivity than straight bonds of similar duration.
- Over the past fifteen months, convertible bonds' record issuance dynamism has sparked a broad deepening and renewal of the investment pool, led by "digital economy" and "covid-19-recovery" names. Thanks to their dual nature, convertible bonds give investors the chance to be actively positioned on both themes with much lower volatility and downside risk than direct equity investments offer - as repeatedly demonstrated historically and again over the past year.
- Overall, we see current cyclical rotation as an opportunity to tactically diversify our investments, rather than a questioning of our long-term quality-growth positioning. 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.
- Despite the decorrelation it would imply as regards the fundamentals of the economy, we believe central banks will strive to keep bond yields low, and not far off their current values, in order to keep fragile economies growing. After the underperformance of growth stocks over the last two quarters, which saw price earnings (P/E) ratios slide by more than 15%, we think the market will now focus on earnings, whose guidance remains strong for growth stocks, while value earnings per share (EPS) expectations have already rebounded strongly, and are therefore more likely to rise in line with the growth of the economy from now on.
- Although the near-term future still looks bright for recovery cyclical stocks as economies are carefully reopening, we stay cautious about the lack of visibility as to when and how fast their business activity can resume and return to pre-crisis levels. In this context, credit quality will remain a cornerstone of our security selection.

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