Q4 2020

UBAM – EMERGING MARKET DEBT OPPORTUNITIES

Quarterly Comment

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

Market Comment

- The fourth quarter was marked by investors' growing optimism as uncertainties linked to the US elections faded while vaccines started to be approved and to be rolled out in several countries.
- With hopes that these vaccines would open the way for a rebound in the global economy, the US treasury curve steepened. 2-year US Treasury rates were down -1 bp to 0.12% while 10-year rates up +23 bps to 0.91%.
- Commodities were also strong. The CRB index was up by 13.0%, thanks notably to the rally in metal prices (iron ore +35%, copper +16%, silver +14%). Oil prices also rebounded by over 20%, with Brent ending the year at 51.8 USD per barrel, a level not reached since the end of February. Gold, given its safe-haven status, underperformed (+0.7%).
- EM local bonds outperformed (+9.6% in USD terms) thanks primarily to USD weakness. In local terms, local bonds were up 2.6% over the period.
- EM sovereign bonds returned +5.8%, thanks to a spread tightening of 81 bps to 352 bps. At a country level, the best-performance came from Angola (+22.5%), Ghana (+19.6%) and Venezuela (+18.1%). In contrast, Lebanon was the worst performing country (-21.9%), followed by Sri Lanka (-13.1%) and Ecuador (-2.4%).
- EM corporate bonds returned 4.3% over the quarter, with spread tightening by 69 bps to 316 bps. The best performance came from commodities sectors: Pulp & Paper (+7.8%), Metals & Mining (+6.8%) and Oil & Gas (+6.2%). In contrast, lower beta sectors like Infrastructure (2.9%), Financials (3.2%) and Utilities (3.3%) underperformed.
- Over the year, EM corporate bonds outperformed (+7.4%) vs. EM sovereign bonds (+5.3%). Local debt underperformed, up only 1.3% in USD terms, as EM currencies depreciated.

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.

Performance Review

- The fund returned 7.07% net of fees over the quarter. As an indication, the performance of the JP Morgan EMBI Global Diversified* ex CCC is estimated at 5.73%.
- All sources of performance contributed positively (credit selection, duration positioning and FX).
- The allocation effect (overweight in corporate bonds) was costly this quarter, but this was offset by the positive effect of selection in both sovereign and corporate issuers was positive.
- In hard currency, at a country level, the best performance came from our positioning in Ivory Coast, Colombia, Sri Lanka, the Dominican Republic and Indonesia.
- In contrast, the worst performance came from our positioning in Turkey, Ghana, Egypt, Chile and Angola.

Portfolio Activity

- Over the quarter, our scorecard moved from “balanced” to “dynamic” territory.
- We traded duration tactically late November and late December, reducing long end interest rate duration.
- We were also more cautious in longer dated spreads by the end of the period, taking profit on some long-dated bonds where spreads appeared tight.
- Region-wise, we increased Africa and Asia at the expense of the Middle East and Latin America.
- At a country level, we favoured China, Egypt, Poland, Hong Kong and Russia.
- In contrast, we sold our remaining positions in Argentina and Slovakia. We also reduced exposure In Colombia, Qatar and India.
- Sector-wise, we increased positions in Industrials, TMT and Consumer companies at the expense of Sovereign, Oil & Gas and Utilities.
- We also increased our positioning in EMFX (RUB, BRL, MXN and EGP).

Outlook

- With the roll-out of vaccines across the world, the global economy is expected to rebound in 2021. This rebound should be faster in Emerging Markets, led by Asia, than in Developed Markets.
- EM corporate fundamentals look solid, with notably less leverage than in the US. This means that we can expect defaults rates to come down in 2021 and to remain lower in EM than those in the US, as was the case last year: in 2020, EM HY corporate defaults stood at 3.5% vs 6.8% in US HY.
- In parallel, with the stock of negatively yielding debt reaching USD 18 trillion and the historically low yields of DM credit markets, investors are expected to continue to look at EM debt as an asset class of choice, leading to new inflows as experienced in late 2020.

- Overall, we continue to favour corporate bonds over sovereign ones, and have selective exposure to local currencies.
- At a regional level, we favour Latin America, Asia and Africa.
- Our largest country exposures are in China (corporate), Brazil (corporate), Colombia (corporate/sovereign) and Chile (corporate).
- At a sector level, our main exposure is in Sovereign, Consumer companies, TMT and Industrials.
- In FX, we have a net long exposure of 15%, mainly in RUB, UYU, MYR, PLN and CNY.

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