UBAM – DIVERSIFIED INCOME OPPORTUNITIES

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

- The last quarter of 2023 has been characterized by the shift in central banks' tone. From the end of October, it has appeared clearer that we may have passed the peak in interest rates. According to its December meetings, the Fed sounded quite dovish. FOMC members revised their inflation expectation lower and implied that the hiking cycle ended, they even started to discuss the timing for the first rate cut. In the US, economic activity continues to be strong. Consumer confidence, Industrial production and retail sales have been on the upside during the quarter. The US economy continued to create new jobs with +150 000 in October and +199 000 in November, and unemployment fell at 3.7%. Inflation moved lower, CPI fell at 3.1% YoY by November and we saw the same trend for the PCE which came out at 3.2%. This combined with the Fed accommodative pushed bond yields lower over the quarter, and US 10yr yield moved 69bps lower to 3.88%. 3yr and 5yr yields fell by 79bps and 76bps to 4.01% and 3.85% respectively.
- Economic data release over December in Europe are confirming the stagnation in activity. European PMI indices are still below 50 and are showing little signs of improvement. So far we don't see any contagion to the real economy and the labor market is strong as unemployment is still low.at 6.4%. Inflation has continued to ease with headline CPI came at 2.4% YoY in November and should therefore be less a drag to economic activity. Despite this context, the ECB reiterated that a potential rate cut is not yet on the table. However, European yields have been falling over Q4 2023, German and France 10yr yields ended the month 82bps and 84bps lower at 2.02% and 2.56% respectively.
- After a spike in October, volatility has fallen through November and December across asset classes and credit spreads tightened. IG spreads fell in the US and Europe over the third quarter by 20bp and 14bp respectively, while High Yield spreads were down by 69bps and 42bps respectively. Spreads across emerging market debt sectors have been tightening as well.

Performance Review

- In Q4, the UBAM – Diversified Income Opportunities posted a +5.6% performance after fees (IC USD share class). This brings year-to-date performance to +7.8%.
- Quarter-to-date, the best contributing segment of the strategy was the core portfolio exposure to Investment Grade credit (+260bps). Our exposure to Emerging Market Debt contributing by 169bps. Our position in CoCos returned 70bps in Q4 2023.
- With the downward shift of the US yield curve, our 4yr-5yr duration exposure contributed the most to the fund's performance this quarter with +157bps.
- As the USD decreased over the quarter, our ex-USD currency exposures had a positive impact on performance quarter to date, by 44bps.

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

- Impacted by the global retreat in yields, our portfolio's yield decreased over the quarter and stood at 5.3% at the end of December, in line with the USD cash rate at 5.3%.
- In line with the overall tightening in credit spreads, the portfolio's average spread moved 30bps lower over the quarter to 159bp by the end of December.
- Our exposure to non-USD currencies is relatively unchanged this quarter, we hold a 1.0% net long exposure to EM currencies. The portfolio holds a 0.8% net short USD exposure as at the 28th December.
- During Q4, portfolio duration has increased by 0.7 from 3.4 to 4.1.
- The portfolio's average credit rating is BBB+ as of the end of December.

Outlook

- When combining the ease in global inflation pressure and the more dovish stance from central banks, it appears clearer that we have seen the peak in rates. This pictures a new environment where downside risk in yields surpasses upside risk. We believe this is the right timing to take on some duration within portfolio. Historical analysis shows that over the 12 months following the latest hike in the monetary tightening cycle, just a little duration risk is enough to outperform cash by more than 2% of the next 12 months. Our preference goes to the short-end and the belly of the curve since the long-end could still be vulnerable to US fiscal issues. We are currently holding an average duration of 4.1. We believe this is the best positioning given the current environment. The curve has been inverted for 12 months now, but we think it is not sustainable. To our view yield curve normalization started since the end of July and recently the steepening accelerated with the 2yr yield falling more than the 10yr and 30yr. We expect the 3-5yr part of the curve to offer an attractive risk-reward profile over the medium term.
- We continue to favour low spread duration and high-quality credit, and, in case of a pullback in credit spreads, we could increase the overall credit risk of the fund as our economic scenario is still excluding a strong recession in 2024, with only a "soft patch" expected over the next two quarters. We prefer Investment Grade to High Yield from a risk-reward perspective. We believe bonds issued by financials are offering attractive yields.
- Despite the lingering uncertainties we believe there are currently attractive opportunities to be found within EM debt exposures. Decreasing inflation, the prospect of less tight financial conditions and potential rate cuts from EM central banks lead to a better outlook for EMD when compared to last year. Within the EM debt sector, we prefer the carry offered by external EM debt to local currency debt.
- We look for opportunities to increase carry in order to deliver a yield higher than the current average cash yield expected for 2024 expected to reach 4.6%.

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