Q3 2020

UBAM – EMERGING MARKET SOVEREIGN BOND

Quarterly Comment

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

Market Comment

- The third quarter was split in two, with the continuation of the market optimism seen in Q2 in July and August and renewed concerns in September amid signs a resurgent virus could lead to more lockdowns and a deeper global recession.
- Over the quarter, US treasury bonds appear fairly stable, masking a rally in July, a sell-off in August when expectations that the worst had been avoided were predominant, and a new rally in September when the pandemic accelerated again. Overall, the curve steepened slightly, with 2-year US Treasury rates down -2 bps to 0.13% and 10-year rates up +3 bps to 0.68%.
- Commodities were also weak in September, on concerns of lower demand but overall stronger over the quarter. The CRB index was up by 7.6%, thanks notably to the rally in metal prices (silver +28%, iron ore +18%, copper +11%, gold +5.9%). Oil prices underperformed, however, up only 2.4%. The OPEC cut demand estimates for its oil by 1.1 million barrels a day, while surplus stockpiles of crude and refined products continue to build up.
- Contrary to many countries around the world, there are already signs that economic activity is picking up in China. Industrial production was up in August by 5.6% year over year. Manufacturing PMI came at 51.5 in September, while non-manufacturing PMI stood at 55.9.
- Overall, EM sovereign bonds rallied (+2.3% over the quarter), thanks to a spread tightening of 42 bps to 432 bps.
- Performance-wise, Investment Grade bonds outperformed (+2.6%) with spreads tightening by 21 bps to 196 bps. High Yield e bonds returned +2.0%, with spreads down 79 bps to 753 bps.
- At a regional level, the best performance came from Latin America (+4.0%) and Asia (+3.0%). In contrast, Africa (+0.4%) and Europe (+0.8%) underperformed.
- At a country level, the best-performance came from Suriname (+36.9%), Ecuador (+10.9%) and Costa Rica (+8.4%).
- In contrast, Lebanon was the worst performing country (-11.2%), followed by Zambia (-4.2%) and Ivory Coast (-3.4%).

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

- Over the quarter, the fund returned 3.06% net of fees over the quarter, and 3.27% gross of fees, compared to 2.32% for the JP Morgan EMBI Global Diversified Index*.
- All sources of alpha contributed positively over the period (carry, spread, duration and FX).
- Main contributors to relative performance:
    - Country-wise, the best performance came from our selection in Argentina. Our overweight in Paraguay, Dominican Republic an Indonesia also contributed positively.
    - In contrast, our overweight in Ivory Coast, as well as selection and overweight in Ghana, Kenya and Russia proved costly.
    - Outside of sovereigns, sector-wise, the fund benefited from its selection in Industrials and Utilities but suffered from its holdings in Oil & Gas.
    - In FX, the fund benefited from our positions in PLN and RUB but suffered from our positioning in PEN.
    - Cash holdings detracted from performance.

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

Portfolio Activity

- Over the quarter, our scorecard remained in “balanced” territory, though the overall score trended down in September as fears of a second pandemic wave weighed on investors’ risk appetite.
- Region-wise, we added exposure to Asia and Europe at the expense of Latin America and Africa.
- In Asia, we favoured China (Real Estate) and Malaysia (local currency sovereign).
- In Europe, we increased holdings in Kazakhstan (Oil & Gas, Sovereign), and added Bulgaria and Azerbaijan sovereign bonds.
- In Latin America, we reduced holdings in Argentina (Sovereign, Provinces), El Salvador and Ecuador, as valuations are becoming expensive: In contrast, we bought Peru and added to our holdings in Brazil and Uruguay.
- In Africa, we bought Angola, taking notably advantage of market weakness in September to buy at attractive levels. The current yields and projected recovery rates, combined with the lower liquidity risks and cheaper bonds prices, make it a compelling case despite the remaining longer-term solvency risks. We sold our position in Ghana (Oil % Gas) and reduced Kenya.

Outlook

- We remain constructive on EM spreads in general, and frontier debt in particular. By the end of August, we had recovered a significant portion of the the extreme spread widening we saw in March, but September saw spreads widen back out. As a result, we see sovereign bonds offering attractive carry and potential for further spread tightening in the coming month, especially in high yield.
- We expect volatility to continue over the coming weeks. IMF meetings taking place in October could bring back private sector involvement discussions, for the weakest credits seeking debt servicing reduction; and the US Presidential election in November is also likely to bring its fair share of uncertainty. But ultimately, when taking a longer-term perspective, we continue to be constructive and have a positive outlook for sovereign debt.
- At a regional level, we favour Africa and Europe at the expense of the Middle East and Asia
- At a country level, our largest cash overweight positions are Guatemala, Russia Paraguay, Nigeria and Indonesia.
- In contrast, our largest underweights are the Philippines (no exposure), Panama (no exposure), Saudi Arabia, Mexico and Qatar.

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