

# International Sustainable Equity

UBS Asset Management separately managed accounts—**Second quarter 2022**

## Market review

Equities and fixed income fell in tandem in June, capping the end to a challenging second quarter and one of the worst first halves of a year in decades for investors. The S&P 500 lost 8.3% for the month, and 16.1% over the quarter. The 20% fall in the index year to date marked the largest first half decline since 1970. Most major equity markets were down for the month and quarter, including a -7.2% return for MSCI Switzerland and -9.2% for MSCI EMU. The sole exception was China, with the MSCI China index returning 6.6% in June and 4.5% over the quarter. Chinese stocks benefited from expectations of a rebound in the second half of 2022 at a time when growth is slowing in much of the rest of the world.

The main reason for the weak global sentiment has been concerns that persistently high inflation will lead to aggressive central bank tightening and undermine consumer spending. In the US inflation rose by 8.6% in May year-on-year, disappointing expectations that price pressures had already passed their peak. Stubborn inflation has elicited a hawkish response from most central banks. The US Federal Reserve raised rates by 75 basis points in June—the largest hike since 1994.

As of 1 July, markets were pointing to around 325 basis points of tightening for 2022 overall, up from around 230 basis points at the start of the quarter. The European Central Bank has moved to tighten policy faster than expected and is signaling plans to hike rates for the first time since 2011 in July. The Swiss National Bank also surprised markets with a 50-basis-point hike in June, which was both earlier and larger than investors had been expecting. This hawkish twist in central bank policy, along with high inflation, was also negative for fixed income investors, who have also faced one of the worst starts to a year on record. All major segments lost ground in June, the quarter, and year-to-date. For the first half of 2022 losses ranged from -20% for emerging market USD sovereign bonds to around 3.7% on senior loans, which were more insulated from tighter monetary policy by their floating rate structure. Geopolitical risks remained high in June, with news that Russia was cutting back gas supplies to Europe—notably with a 60% reduction in exports to Germany via the Nord Stream 1 pipeline. The BDI industrial association in Germany warned that a full cessation of gas supplies from Russia would make a recession inevitable.

## Outlook and strategy

Global equities struggled in the first half of 2022. Geopolitical uncertainty, inflation fears, tighter monetary policy and concerns around an economic slowdown have all weighed on market sentiment.

We anticipate further volatility as markets grapple with economists ramping up their recession warnings with the perfect storm of inflationary pressures, tightening monetary policy, and signs of slower growth. We continue to screen for high quality, cash generative companies that are resilient in an environment where margins are coming under pressure, and that we believe can leverage pricing power as a key driver of relative performance going forward. Overall, we believe the recent market volatility has reinforced the importance of staying true to our investment process and active stock selection will remain crucial in this market environment.

We believe the portfolio remains well-balanced and looking ahead, we continue to upgrade the quality of the portfolio at the margin. Currently, the strategy's largest sector overweights are to Consumer Discretionary and Communication

Services, while we are underweight Utilities and Real Estate. From a country perspective, UK and Indonesia are the largest overweights, while we are underweight Canada and Australia.

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#### **Risk considerations**

**Market risk.** The risk that the market value of a Portfolio will fluctuate as the stock and bond markets fluctuate. Market risk may affect a single issuer, industry or section of the economy, or it may affect the market.

**Foreign investing and emerging markets risks.** Investing internationally presents certain risks not associated with investing solely in the US such as currency fluctuation, political and economic change, social unrest, changes in government relations, differences in accounting and available legal remedies, and the lesser degree of accurate public information available. A decline in the value of foreign currencies relative to the US dollar will reduce the value of securities denominated in those currencies. Also, foreign securities are sometimes less liquid and harder to sell and to determine the value of than securities of US issuers. Each of these risks is more severe for securities of issuers in emerging markets countries.

US companies include any company organized outside of the United States, but which (a) is included in an index representative of the United States; (b) has its headquarters or principal location of operations in the United States; (c) whose primary listing is on a securities exchange or market in the United States; (d) issues securities that are guaranteed by the United States government, its agencies, political subdivisions or instrumentalities; (e) derives at least 50% of its revenues in the United States; or (f) has at least 50% of its assets in the United States.

**Depository receipts.** Generally, exposure to non-US securities is achieved by investing in depository receipts. Depository receipts are securities that evidence ownership interests in securities or a pool of securities that have been deposited with a depository (the “deposited securities”). Depository receipts may be sponsored by the issuer of the deposited securities or unsponsored and include, among other types of depository receipts, American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs). A holder of depository receipts may have the ability to cancel his or her depository receipts and receive the underlying deposited securities.

ADRs are receipts typically issued by a US bank or trust company evidencing ownership of securities of foreign issuers on deposit with a bank or other custodian. Generally, ADRs are denominated in US dollars and designed for use in the US securities markets. ADRs may be listed on a national securities exchange or may be traded in the over-the-counter market.

GDRs are receipts generally issued by a non-US bank or trust company evidencing ownership of securities of foreign issuers on deposit with a bank or other custodian. The issuer of securities on deposit in respect of GDRs is often an issuer located in an emerging or developing market. Typically, the depository for a GDR is a bank or trust company located in the foreign jurisdiction in which the deposited securities principally trade.

There are risks associated with investing in depository receipts. The rights of a holder of a depository receipt in respect of the deposited securities may be less than the rights held by someone who holds the securities on deposit directly.

Un-sponsored depository receipt facilities are typically established without the participation of the issuer of the deposited securities. In un-sponsored facilities, the depository usually charges holders of the depository receipts fees for the deposit and withdrawal of the deposited securities, the conversion of dividends into the currency in which the depository receipts are denominated, the disposition of noncash distributions, and the performance of other services. Also, the depository of an un-sponsored facility frequently is under no obligation to distribute investor communications received from the issuer of the deposited security or to pass through voting rights related to the deposited securities to the holders of depository receipts. In a sponsored facility, the issuer of the deposited securities typically assumes the obligation to pay some or all of the depository’s transaction fees and the depository typically agrees to distribute notices of shareholder meetings, voting information, and other shareholder communications and information to the holders of depository receipts at the request of the issuer of the deposited securities.

Although transactions in depository receipts may settle in accordance with the norms of the market on which they trade, depository receipts generally involve all the other risks associated with investing in foreign securities and in assets denominated in foreign currencies. Also, the values of depository receipts will generally be affected by many of the same factors that affect the performance of the deposited securities, including the financial performance of the issuer of the deposited securities, supply and demand for the deposited securities, and market and economic conditions. Although the performance of depository receipts may tend to correlate with the performance of the deposited securities, there can be no assurance that they will so correlate or that their values will not deviate materially at times. Depository receipts may be or become illiquid and may be less liquid than the deposited securities are in the markets in which the deposited securities principally trade.

Income or gains from investing in securities of foreign issuers, including through ADRs, GDRs and F shares, may be subject to withholding or other taxes, and possibly reporting requirements, imposed by foreign jurisdictions. US investors may be able to credit foreign taxes paid against their US federal income tax liability, or to deduct such taxes in computing their US federal taxable income, although the ability to claim such credits or deductions may be subject to significant limitations. In addition, special US tax rules may apply to particular investments in foreign securities. Investors should consult their tax advisers with respect to the specific tax consequences to them of an investment in a separately managed account, including the tax consequences of investments in securities of foreign issuers.

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