

Fund Investment Report



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Fund Information

Fund objective

The investment objective of the Fund is to generate a high level of income by primarily investing in a diversified portfolio of credit securities including investment grade bonds, high yield bonds, credit default swaps and money market securities (including commercial bank loans) while exhibiting lower volatility relative to the global high yield market.

Approach to ESG integration and stewardship

ESG integration and stewardship are integral to delivering sustainable returns. Through quantitative data and fundamental bottom-up research, we assess the absolute and change in ESG performance of companies. Engagement allows us to understand the effectiveness of their approach, the management of strategic issues and to exert positive influence.

Fund inception date	01 May 2014
Fund value	USD936.90m
Lead Fund Manager	Fraser Lundie
Co-Fund Manager	Andrey Kuznetsov
Base currency	USD

Fund Commentary – Q2 2019

Market and Performance Review

There were a few interesting developments in the global macro environment in the second quarter of 2019. Markets have been supported by increasingly accommodative Central Banks and the hope of progress in trade tensions. The Federal Reserve decided not to cut interest rates at its June meeting but indicated there may be rate cuts ahead. ECB President Draghi hinted at further monetary policy easing if inflation outlooks fails to improve. UK securities performed well over the quarter despite Brexit related uncertainty and the resignation of Theresa May.

The technical picture remained strong. Even though net supply turned positive for the first time since the start of 2018 as the weaker loan market led to issuers tapping the bond market instead. This positive supply was well digested by the market given the tailwind from strong inflows into the asset class as credit is again in strong demand.

Credit markets drew support from the growing stock of negative yielding assets. Higher quality performed better than lower quality on the back of demand for credits that have means to withstand macro volatility. Emerging Market bonds also had a positive quarter benefitting from a more supportive monetary policy backdrop.

Individual names that contributed to the Strategy's positive performance over the period included, Banking name Commerzbank, Basic Industry name Toll Brothers, and Financial Services name Air Lease. Individual detractors included Utilities name NRG Energy, Banking name Deutsche Postbank and Energy name Range Resources.

From a ratings perspective BB and BBB names contributed the most to absolute performance. Geographically, absolute performance was driven from North America, Western Europe, the UK and Latin America. From a Strategy perspective, strong performance came from the Best Selection bucket, supported by Income, Quality and Tactical trades.

Activity

Overall, lower quality issues continued to underperform, so the Strategy benefited from its higher quality exposure. US homebuilders remain our top sector pick in US High Yield, and we increased our allocation to the sector through Toll Brothers in the Best Selection bucket. In Financials we added higher quality securities such as Commerzbank's newly issued AT1 (also part of the Best Selection bucket).

We switched CDS into cash bonds where basis is at the wides, such as in AerCap and L Brands. We sold names we believed had limited upside potential, such as Ziggo and UPCB.

As the High Yield market's convexity has deteriorated, we reduced exposure to securities trading above their call price, such as IQVIA, Altice, CSCHLD, LKQ, Severstal and ADT. To protect the Strategy we initiated a short position in the Bund and also on Syngenta due to our concerns about its ESG profile. In Utilities we increased our pair trade between NRG Energy and its renewable energy spin off Clearway Energy.

Fund Characteristics

Duration (years)	2.45
Duration Times Spread (%)	75.52
Option Adjusted Spread (bps)	285
Average Rating	BB
Average-Weighted Coupon (%)	4.82
No. Issuers	81
Concentration of Top Ten Positions (%)	29.77
Yield-to-Worst	3.99
Spread Duration (years)	3.04
Average Maturity (years)	9.17

Outlook

A dovish tone from the Central Banks across the globe and supportive comments from the G-20 meeting improved investor confidence. Accommodative monetary policy is back on the agenda of the major central banks; this will increase the share of negative yielding assets and will remain a tailwind for spread products. Better risk adjusted return potential in investment-grade and the higher-rated segment of High Yield credit given the slowdown in the global economy.

Overall, we favour credits that are well positioned for macroeconomic weakness and have levers such as dividend cuts available to them.

With credit curves currently steep, we favour lending for longer over to stronger lenders. This is true in both High Yield and Investment Grade. Negative basis is at the very wides making cash more attractive than CDS in certain capital structures.

The convexity of the High Yield market worsened on the back of stronger performance in an environment of stable fundamentals and supportive technical backdrop. For High Yield portfolios, it is becoming increasingly important to maximise the convexity by re-allocating capital away from negatively convex securities.

Performance Contribution – 1 Month

Top 10 Issuer Contributors to Total Return – Asset Level

	Contribution (bps)
Ardagh Packaging	9
Enbridge	7
Enterprise Products	7
Allergan	6
Clearway Energy	6
Petrobras	4
Commerzbank	4
EDF Energy	4
Intesa Sanpaolo	4
Toll Brothers	4

Top 10 Issuer Detractors to Total Return – Asset Level

	Contribution (bps)
Prosecure	-7
Range Resources	-5
Dell	-3
Antero Resources	-2
Banca Monte dei Paschi di Siena	-2
American Axle	-2
Phoenix	-1
Syngenta	-1
Hess	-1
Fiat	-1

Sector Level

	Contribution (bps)
Basic Industry	21
Energy	16
Capital Goods	13
Healthcare	10
Utility	10
Financial Services	8
Telecommunications	6
Banking	2
Media	1
Retail	1
Leisure	1
Automotive	0
Transportation	0
Insurance	-2
Technology & Electronics	-3
Index	-3

Rating Level

	Contribution (bps)
AAA	0
AA	0
A	0
BBB	38
BB	33
B	11
CCC	-2
NR	0

Regional Level

	Contribution (bps)
North America	44
Western Europe	16
Eastern Europe	7
United Kingdom	-2
Other Developed Markets	2
Emerging Markets	
Latin America	10
Asia	0
EMEA	3

Strategy Level

	Contribution (bps)
Best Selection	72
Pair Trades	6
Income - Quality	4
Income - Enhanced	3
Curve	2
Event Driven	1
Income - YTC	0
Tactical	0
Outright Short	-2
Capital Structure	-3
TICS Bollinger	-3

Top 10 Issuers*

Market Weight

	Country	Sector	Rating	Weight (%)
Telefonica	Colombia	Telecommunications	BB	3.73
BHP Billiton	Australia	Basic Industry	BBB	3.53
General Motors	United States	Automotive	BB	3.48
ArcelorMittal	Luxembourg	Basic Industry	BBB	3.11
AerCap	Ireland	Financial Services	BB	2.77
Ally Financial	United States	Banking	BB	2.70
Telecom Italia	Italy	Telecommunications	BB	2.64
Toll Brothers	United States	Basic Industry	BB	2.63
Commerzbank	United States	Banking	BB	2.63
Bank of Ireland	Ireland	Banking	BB	2.55

Spread Duration (SD)

	Country	Sector	Rating	SD (Years)
Allergan	United States	Healthcare	BBB	0.24
Kinder Morgan	United States	Energy	BBB	0.24
AerCap	Ireland	Financial Services	BB	0.19
Suzano	Brazil	Basic Industry	BBB	0.18
Toll Brothers	United States	Basic Industry	BB	0.17
Charter Communications	United States	Media	BB	0.17
Air Lease	United States	Financial Services	BBB	0.16
Enbridge	Canada	Energy	BB	0.15
HCA Holdings	United States	Healthcare	BB	0.15
Hess	United States	Energy	BB	0.15

Duration Times Spread (DTS)

	Country	Sector	Rating	DTS (%)
Phoenix	United Kingdom	Insurance	BBB	4.78
Suzano	Brazil	Basic Industry	BBB	3.98
Kinder Morgan	United States	Energy	BBB	3.91
L Brands	United States	Retail	BB	3.83
Allergan	United States	Healthcare	BBB	3.69
Ardagh Packaging	Ireland	Capital Goods	B	3.28
Range Resources	United States	Energy	BB	3.05
Enbridge	Canada	Energy	BB	3.01
Petroleos Mexicanos	Mexico	Energy	BB	2.98
HCA Holdings	United States	Healthcare	BB	2.88

Strategy Allocation

	Weight (%)	SD (Years)	DTS (%)
Best Selection	79.07	4.46	86.31
Capital Structure	-4.23	-0.20	0.05
Curve	-5.61	-0.27	-0.07
Event Driven	-13.29	-0.35	0.30
Income - Enhanced	5.61	0.11	0.70
Income - Quality	15.37	0.45	2.00
Income - YTC	4.35	0.08	1.23
Outright Short	-14.31	-0.62	-5.11
Pair Trades	1.80	0.07	1.39
Tactical	0.66	0.04	2.28
TICS Bollinger	-15.03	-0.74	-13.79

Maturity Spread

	Weight (%)	SD (Years)	DTS (%)
< 1 year	26.67	0.26	11.51
1-3 years	1.81	0.08	3.79
3-5 years	-26.08	-1.01	-17.67
5-7 years	19.21	0.41	16.92
7-10 years	51.10	1.68	42.63
10-15 years	7.05	0.31	5.86
15-20 years	8.76	0.50	13.30
20-25 years	6.66	0.46	13.30
25-30 years	3.72	0.28	7.63
> 30 years	1.10	0.07	2.73

Currency Allocation

	Weight (%)	SD (Years)	DTS (%)
EUR	-32.83	-1.07	-13.07
GBP	29.32	0.61	20.02
USD	103.51	3.51	93.05

Regional Analysis

	Weight (%)	SD (Years)	DTS (%)
North America	68.14	2.39	68.39
Western Europe	-12.37	-0.45	-1.44
Eastern Europe	9.39	0.18	4.19
United Kingdom	14.27	0.37	13.22
Other Developed Markets	7.50	0.12	1.94
Emerging Markets			
Latin America	11.71	0.48	14.97
Asia	0.00	0.00	0.00
EMEA	1.35	-0.06	-1.26

Top 20 Country Analysis

	Weight (%)	SD (Years)	DTS (%)
United States	63.91	2.25	64.40
United Kingdom	14.27	0.37	13.22
Ireland	14.10	0.36	8.67
Brazil	9.57	0.40	11.03
Italy	8.69	0.17	4.78
Russia	8.24	0.16	3.14
Spain	6.78	0.11	0.37
Australia	6.41	0.10	1.60
Germany	4.24	0.03	1.39
Canada	4.23	0.15	3.99
Netherlands	3.72	0.04	0.43
Luxembourg	3.69	0.04	-0.57
Mexico	2.14	0.08	3.94
South Africa	1.35	-0.06	-1.26
Turkey	1.15	0.03	1.05
Hong Kong	1.09	0.02	0.34

Ratings Analysis

	Weight (%)	SD (Years)	DTS (%)
AAA	0.00	0.00	0.00
AA	-5.86	-0.04	-0.02
A	0.06	0.00	0.02
BBB	45.99	1.59	45.62
BB	64.50	1.57	49.23
B	4.03	0.04	3.70
CCC	0.46	0.02	1.78
NR	-9.17	-0.14	-0.34

Sector Analysis

	Weight (%)	SD (Years)	DTS (%)
Automotive	10.24	0.14	0.81
Banking	25.83	0.59	13.83
Basic Industry	12.40	0.45	20.94
Capital Goods	10.98	0.19	6.37
Energy	18.57	1.00	32.16
Financial Services	13.06	0.39	6.54
Healthcare	14.20	0.44	9.71
Hedges	-27.29	-0.74	-18.26
Insurance	6.66	0.20	8.56
Leisure	0.75	0.02	1.24
Media	3.50	0.11	3.69
Retail	-2.82	0.02	5.00
Technology & Electronics	-2.88	-0.02	1.34
Telecommunications	17.27	0.30	5.30
Utility	-0.46	-0.03	2.77

All data as at 31 July 2019. Duration Times Spread (DTS) recognises that bonds with a longer duration, wider spread or both, have a higher beta and therefore greater contribution to index returns. All analysis figures relate to pure credit exposure, excluding cash and hedging.

Data Source: Hermes and Northern Trust. Ratings shown may be sourced from Moody's, S&P, Fitch or Bloomberg.

Contact us:

If you have any general questions concerning your investment, or specifically related to the content of this Fund Investment Report, please let us know using the contact details below.

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