

Value Bonds 2018 - 50/50

FIXED INCOME

Volatility rising

Slightly wider spreads

Markets As political tensions and market volatility increased during August, investors turned their attention to more safe asset classes. Investment Grade bonds rose by 0.66 percent in August, whereas High Yield settled close to zero.

The escalation in rhetoric surrounding North Korea as well as the American debt ceiling debate resulted in a temporary risk off tone in the first half of August, which hit both the equity market and high yield bonds. High yield spreads widened by 20-30 basis points and the VIX – a measure of stock volatility – increased 40 percent as a result. Credit spreads tightened into the end of the month but ended the month slightly wider.

The labor market in the US continued to improve bringing the unemployment rate down to 4.40 percent in August and economic growth in the US was revised up to 3.0 percent. The big puzzle is the lack of inflation as price pressures have moved annual inflation lower and further from the FED's 2.0 percent target, which is the similar picture we see in the Eurozone. Second quarter earnings season continued in August and were in line with expectations, generally confirming solid earnings results.

During the month of August second quarter GDP figures for the Eurozone were revised up to 2.2 percent, which is the highest since the Euro-crisis in 2011. The leading indicators for the Eurozone are pointing sharply higher, so a recession

is definitely not around the corner. Despite a strong outlook, long German interest rates dropped about 20 basis points throughout the month. The drop might be explained by lower import prices and inflation expectations due to the stronger euro, which has rallied 13 percent since year-end.

The Eurozone's fundamental challenges remain out of the headlines at this point, and nothing indicates that the German general election on September 24 will change that. Nevertheless, we remain cautious on the European part of the credit universe for valuation reasons.

Low duration impacts performance

The Portfolio With no performance from falling interest rates, the portfolio just barely covered the running costs and ended the month just above zero.

One energy issuer stood out from the rest following the release of quarterly report. The company continued to build its cash position, increasing the likelihood of an early call of the bond. On the negative side, the fund lost marginally on the position in an Israeli pharmaceutical, who disappointed the market with their second quarter numbers. As a result, we decided to sell the position from the fund.

During the month, one position was called and one position matured. These bonds were replaced with four new names across consumer non-cyclicals and real estate.

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Strategy

High Yield Value Bonds Short Duration 2018 invests in short-dated corporate bonds, cf. the fund's prospectus. Bond selection is based on the value approach, meaning that the team focuses on bonds issued by companies with healthy long-term earnings power and strong balance sheets as well as an expected ability to service outstanding debt. The portfolio is diversified across sectors, regions and credit ratings. At least 2/3 of the portfolio are invested in High Yield bonds. The maturity date of the Fund is December 31, 2018.

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