

Investment Grade Value Bonds

FIXED INCOME

Full-year 2016 beats benchmark

Positive absolute return

Markets Credit markets were positive through December with credit spreads somewhat narrowing. US 5- and 10-year interest rates increased by 5-8 bp, which was more or less canceled out, by German 5- and 10-year interest rates decreasing by about 8 bp. Thus, benchmark return of 0.49% in December was primarily driven by a positive spread development leaving benchmark full-year 2016 return at 4.45%.

In 2017, political risk related to the viability of the Eurozone is likely to pick up due to the upcoming Brexit negotiations and elections in the Netherlands (March 15), France (April 23 first round and May 7 second round) and Germany (most likely September). Combined with the ongoing challenges within the Italian banking system, we generally take a cautious stance on Eurozone credits.

The outlook for North American and Asian credits appear more attractive from both a pricing perspective, an economic growth perspective and a political risk perspective.

Small outperformance in December

The Portfolio December's gross performance of 0.59% was 0.10% better than benchmark (0.49%). Performance attribution was broad based and was helped by solid performance of the fund's American exposure. November's post-Trump addition of the state-owned Mexican oil company Petroleos Mexicanos (Pemex) is up more than 6%, adding 3bp to overall fund performance. The ability to exploit excessive sell-offs not supported by fundamentals owes to the defensive nature of the portfolio. Thus, our focus on capital preservation in a

low interest and now spread environment goes hand in hand with the ability to take advantage of sell-offs.

The full-year 2016 gross performance of 5.39% is 0.94% ahead of benchmark (4.45%) in spite of having a lower level of duration in the portfolio (about 5) versus the benchmark (about 6) during Q1 2016, where interest rates fell sharply. During H1 2016, the duration mismatch resulted in an opportunity cost of approximately 1.0%. We aim to keep the future duration mismatch low, so it no more materially can influence relative performance.

Through December, the regional weights were stable: North America 52% (down from 53%), Western Europe 26% (down from 28%) and Asia/Pacific resting at 12%. With an underweight of specifically Eurozone credits (12% versus benchmark 19%) the fund is well positioned to weather and potentially exploit sell-offs related to increased economic and political uncertainty mentioned in the Markets paragraph.

For some time, the fund has carried a five-star Morningstar rating based on its three-year and five-year history. In November 2016, the fund reached its 10-year anniversary, which means that also 10-year performance is taken into account. Due to poor performance and high volatility in the period November 2006-November 2011, the fund lost two of its five stars in December 2016. This is not related to performance over the past five years. A risk framework developed in 2015 effectively prevents the fund from re-experiencing what happened in 2006-2011.

See performance and fund data

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Strategy

Investment Grade Value Bonds invests in global 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 Investment Grade bonds.

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