

Investment Grade Value Bonds

FIXED INCOME

Pre-Brexit levels swiftly restored

Dropping spreads, stable rates

Markets The Brexit vote on 23 June sparked some good buying opportunities, which benefitted the portfolio. However, the price set-back was short lived, as the brexit doomsday scenario painted by the 'Stay' campaigners was dismissed by the general IG market. Thus by mid-July, UK assets had resumed the same price levels as before the referendum.

German, UK and US 5 and 10-year government yields remained near record lows throughout the month. Combined with ECB's ongoing corporate sector purchase program spreads grinded tighter. Thus spreads, not rates, dominated July's absolute benchmark performance of 1.5%.

Beginning in June and accelerating in July, negative yields in the government space is spilling into EUR denominated Investment Grade corporate bonds, where the majority of all senior issues with maturities in 2016, 2017, 2018, 2019 and even 2020 and some 2021s are trading at negative absolute yields. We handle this challenge by reducing the portfolio's exposure within this segment, which may temporarily lead to an elevated cash level.

Outperformance

Performance July's performance was notable better than benchmark. This is partially explained by solid performance within the segment of North American corporate hybrids as well as some British subordinated bonds (Barclays in particular being up by 4-5% in a few weeks) bought cheaply shortly after the Brexit vote on June 23. Slightly higher interest rates helped relative performance marginally due to a remaining duration mismatch of 0.5 (6.0 versus benchmark 6.5).

Year-to-date performance is slightly below the benchmark. This can be attributed to the lower level of duration in the portfolio (about 5) versus the benchmark (about 6) during Q1 2016 where interest rates fell significantly. Adjusted for the duration mismatch the portfolio would have been slightly ahead of benchmark. We aim to keep duration mismatch as low as possible.

European underweight reduced

Portfolio Changes During July, the European exposure was increased by 5 percentage points to 29% by adding Barclays Bank, Danske Bank, Munich Re and the Finnish energy company, TVO, at attractive levels. However, the fund remains slightly underweight relative to benchmark (31%).

The Asia/Pacific exposure rose to 13% from 11% (benchmark 10%) by adding Korea Hydro & Nuclear Power, the Singaporean telco company SingTel Group and the Hong Kong based real estate company, Swire Pacific. All three additions bring valuable diversification benefits to the portfolio and are strong credits individually carrying solid A or AA credit ratings.

Among US names, moderate additions were made in General Electric, 3M Company, the aerospace and defense group, United Technologies, Kellogg Company, Moody's Corporation, Wells Fargo and more. Still, the North American exposure decreased by 9 percentage points to 52% (versus benchmark 55%). This was caused, not by selling, but by dilution, as a significant inflow into the strategy, increasing combined AUM to EUR 162m from EUR 117m during July, primarily was invested in other regions.

Strategy

This strategy aims to capture consistent income and minimize principal loss within the Investment Grade universe. Through careful credit research, the team strives to identify companies that will have adequate cash flows to meet their principal and interest obligations. The team also considers the macro-economic environment and performs an ongoing assessment of relative value and risk.

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