

Corporate Value Bonds

FIXED INCOME

Brexit caused volatility in June

Focus on the UK

Markets The month of June was characterized by considerable volatility – both before and after the British referendum on the association to EU, which clearly was the most important event in June. The market was generally positioned for a “remain” and when news broke early in the morning of the 24th of June that the United Kingdom had chosen to leave the EU, a shock wave went through the markets. The Pound immediately fell 8% compared to the Euro, which itself dropped vs. the US Dollar. Equity markets also showed large sell-offs – especially in Europe and especially for financial stocks. Interest rates and rate expectations dropped to new lows. The price of gold increased and the US Dollar and the Yen rallied – all of it in a significant turnaround from moderate risk-willingness to explicit risk-aversion. On the same day, however, the nervousness receded and most of the risky assets have already regained much of the lost territory. Global government yields have continued to tighten and the number of bonds on negative yields continues to hit new records. There was no rate hike in June in the US, not unexpectedly, as labour numbers in May were very weak. Market expectations remain for rates to stay lower for longer. Emerging markets spreads have widened marginally during the month but that has been offset by rate compression.

Took some losses, but core doing ok

Performance The fund delivered negative performance of around 1% for the month despite the benchmark being up close to 1%. The two best performing sectors were Information Technology and Healthcare, which are two sectors that have been increased significantly over the past months, while the worst performing sectors were Energy and Industrials.

The best performing position was a Metal & Mining company in Australia, as the recovery on the restructuring is closing in on a range above where the bond was trading, while the second best position was a large Oil & Exploration company that was added to the portfolio in the recent months. The worst performing positions were two Energy services companies where we chose to reduce both positions by two thirds (equivalent to ca. 3% of the portfolio) at a loss as both companies have limited contracts, and thus a positive outcome is several years out in the future, with the view that they are better places to deploy the capital in the meantime. These positions cost us 1% combined during the month and are positions we have wanted to reduce for some time and despite the losses we found the prices to be at good levels.

Increased in US and in UK

Portfolio Changes Apart for the reductions mentioned above, we have reduced and exited several other of our legacy Energy and Industrial positions, and some at a profit, as risk appetite continued in the first part of the month. In addition, we reduced our UK AT1 exposure up to the Brexit vote as a “remain” seemed to be almost fully priced in. We added exposure in the US mainly through both the primary and through the secondary market, almost closing the significant underweight the portfolio had towards the US at the beginning of the year. This was across sectors such as Healthcare, Consumer Discretionary and Information Technology. In addition, we added exposure in the UK on the day after the Brexit vote, as we found some stable Consumer Discretionary and Financial names were punished too much in the selloff. We also participated in the new issue of an Argentinian Cable Company and increased the position in a Brazilian “fallen angel” Chemicals company. As we enter the summer period we look to take advantage of opportunities.

Strategy

The strategy aims to capture consistent income and minimize defaults and principal loss. 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.