

Emerging Markets Corporate Value Bonds

FIXED INCOME

Brexit is – so far – a positive

Markets The EU lost a member-country in June, as the UK decided to leave the European Union. The polls that were taken before the election indicated that it was going to be a very close call between the stay and the leave voters.

The picture was quite different if you followed the UK book-makers before the election. They put the odds for a vote to leave at 25% in the beginning of the week of the election. On the evening of the election the chances of a "Leave" vote was down at about 10%. Markets saw it the same way, so markets were naturally surprised when the news came out and a flight to safety began on Friday morning June 24. US 10 year rates dropped in the morning from around 1,75 % to around 1,45 % as investors fled to the safety of government bonds. At the same time, the USD was up, appreciating around 4 %.

Precious metals continued up in June and especially after the Brexit vote, as the market perceives it as a safe-haven asset. The story is somewhat different when looking at base metals, like aluminium and cobber. Price-wise they performed well in June - they were up - but dropped right after the election result, only to recover in the following days. Base metals have been the least impacted of all the commodity markets as they are much more tied to demand from China. Oil is a commodity with a stronger link to the USD and dropped – marginally - in June.

What will be the policy response to Brexit? No doubt – Brexit has created more volatility in general and uncertainty about global economic growth. This will put pressure on the FED to postpone the promised rate hike, quite possibly into 2017. Also, it would be natural for the Central

Bank in the UK to pursue an expansionary monetary policy to accommodate the shock.

Positive performance

Performance EM Corporate bonds performed very well in June – even in the face of Brexit. The election created some volatility, with corporate bonds down right after the election - the larger more liquid EM credits were down by 1-4 points Friday morning and further down on Monday 27th, with India HY performing the worst followed by Brazil, Russia and China. The bonds recovered after a couple of days and total returns for June was virtually unaffected by Brexit.

One thing to note is that credit spreads in June actually widened, which is normally an indication that bonds are not performing well. But, since US yields dropped so much – we actually saw a lower and flatter US yield curve – total returns were positive. This is because of the flight to quality that happened right after Brexit and because of expectation that the FED will not hike rates anytime soon. As a result, this also made longer maturity credit bonds outperform shorter dated credits in a significant way.

The fund gave a positive total return, but lagged the benchmark because of the duration underweight in the fund.

Among the best performing credits were a Brazilian low-cost airliner and a Russian gold miner. Worst performing credits were among telecommunication companies: The fund has investments in a mobile phone network provider with operations across the Caribbean and Central America. The company reported results in June with no negative surprises. But rumors in the market about potential asset acquisitions were taken negatively by the market, and we saw the bond underperform in June.

Strategy

The strategy focuses on companies with strong or improving underlying credit fundamentals and good growth prospects, across the entire rating universe. It also aims to limit concentration risk by diversifying across countries, industries and issuers. The strategy combines top down macro-economic research with bottom-up fundamental credit and country analysis.