

Investment Grade Value Bonds

FIXED INCOME

Prepared for Brexit opportunities

Stable spreads, dropping yields

Markets The Brexit on June 23 came as a big surprise to the corporate bond market, resulting in substantial volatility in the days that followed. However, net movements in credit spreads at month-end were small compared to end-May with financials widening somewhat and non-financials tightening somewhat. There were no material differences in spread movements across rating brackets. In terms of capital structure, financial tier 2s underperformed the rest of the market. The referendum had a much more pronounced effect on government yields, which fell sharply: German 5 and 10 year Bund yields were down 0.19% and 0.27%, UK Gilts yields dropped 0.55% and 0.56% – and US Treasury yields fell 0.36% and 0.37% on the back of weak labor market figures. Thus rates, not spreads, totally dominated June's absolute benchmark performance of 1.75%.

Robust portfolio

UK exposure The portfolio is robust and well prepared to exploit the potential opportunities following a Brexit by having good liquidity, defensive non-domestic UK positions, an underweight of Europe (24% versus 31%) and a significant un-utilized risk budget. Thus the Brexit result represents an opportunity to potentially pick up cheapened high quality bonds rather than a challenge. The total UK issuer exposure is 7.1%, which is slightly below benchmark (7.5%). The UK bank exposure is very low (0.7% in Lloyds and Barclays combined) of which the latter was added to the portfolio at attractive levels following Brexit. Almost half of the UK exposure is in Rolls-Royce (1.8%) and British American Tobacco (1.5%) both immaterially affected by Brexit. Total currency exposure to GBP is 3.6% and USD is 41.5%. All currency exposure is hedged 90% against EUR. The remaining 10% non-hedged position means that the current post-Brexit depreciation of

GBP against EUR of approximately 8% burdens the portfolio's performance by about -3bp ($0.036 \times 0.08 \times 0.1 \times 100\%$). Accordingly, the current post-Brexit appreciation of USD against EUR of approximately 2% benefits the portfolio's performance by about +8bp ($0.415 \times 0.02 \times 0.1 \times 100\%$).

Small underperformance

Performance June's gross performance of about 1.61% was slightly below benchmark (1.75%). This is explained by a small remaining duration mismatch of 0.3 (6.1 versus benchmark 6.4). Year-to-date the gross performance of about 4.73% is running about 0.8% points behind 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. During June, the duration mismatch between the fund (5.9) and the benchmark (6.3) decreased by 0.3. We aim to keep the duration mismatch low, so it no more can influence relative performance materially.

Kellogg added, Honeywell sold

Portfolio Changes During June, the exposure to North America increased by 2 percentage points to 61% (versus benchmark 55%) by adding the American food company, Kellogg Co, and by increasing the exposure to the tobacco company, Philip Morris Intl. During the month the fund sold the position in the electrical equipment manufacturer, Honeywell International. The French oil company, Total, was sold during the month. In the Asia/Pacific space Australia and New Zealand Banking Group (ANZ) and Commonwealth Bank of Australia were added to the portfolio. This brings the total Asia Pacific exposure of 11% above benchmark (10%).

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.