

Value Bonds 2019 - 50/50

FIXED INCOME

Steady performance 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.

Steady performance

Performance The fund delivered a positive return in June. The financial sector was the best performing sector in the portfolio followed by the materials sector. Energy and consumer discretionary were the two worst performing sectors.

The best performing position in the portfolio in June was an iron ore producer which has its main assets in Brazil. The company benefitted significantly from the rebound in the iron ore price in June. The company has the lowest costs among the iron ore producers for which reason the credit team sees this company as the “last man standing” if the iron ore price should decline significantly going forward. Another strong performing position was a major oil- and gas company in Brazil. Both positions benefited from the currency strength in Brazil.

The worst performing position in the portfolio in June was the usual high beta position in the portfolio - the oil service company that provides seismic surveys for major oil companies. The oil price development in June was flat and ended the increasing trend from April and May. This company is the strongest in the sector with the most cost efficient seismic vessels. Another weak performing position was a UK bank which suffered due to the “leave” vote in the UK.

Some buying of the dip

Portfolio Changes During June we increased a Mexican position and added three new positions to the portfolio. One Asian automotive producer, one secured mining bond and post Brexit volatility we added a UK headquartered education bond to the portfolio. We have been surprised how well short dated high yield has performed both in Europe and the UK. Given negative yields growing among government bonds and ECB buying corporates, we will not be surprised to see continued compression of yields in short dated high yield.

Strategy

The strategy aims to provide a positive absolute return on a mid-term horizon by investing in short-dated corporate bonds. The selection process is based on in-house bottom-up research with focus on companies with strong cash flow. Our approach also makes it possible to exploit market premiums from less liquid issues and out of favour situations.