

## Investment Grade Value Bonds

FIXED INCOME

# Three European bank wind-downs

## Return burdened by higher rates

**Markets** Credit markets were flattish through June with stable credit spreads across the board. Combined with somewhat higher interest rates, June's benchmark return was turned into negative territory (-0.1%). H1 2017 benchmark return amounted to 2.4%.

The muddy result following the UK general election had no significant impact on credit markets. With also the Dutch and French elections behind us, attention centered on European bank risk:

For some time we have highlighted the problems within the Italian banking system. On June 26 two Venetian banks, Popolare di Vicenza and Veneto Banca, was wound down. Italian taxpayers pledged EUR 17bn to meet losses on bad assets. Good assets were transferred to Italy's second largest bank, Intesa Sanpaolo, for the sum of one euro. The event highlights the political factor involved, as senior bondholders avoided haircuts at the expense of taxpayers which stands in contrast to the whole purpose of the newly introduced EU banking union.

On June 7, Banco Santander took over Banco Popular Español. All operations continue. Shareholders and AT1 holders got zero. Senior debt obligations were taken over by Santander without haircuts and Santander issued EUR 7bn of new equity capital recapitalizing the activities taken over. Notably, T2 capital was converted into shares and those shares was transferred to Santander for the price of one euro – effectively hitting T2 holders equally hard as AT1 holders.

This development supported our cautious stance on Eurozone credits in general and domestically oriented Eurozone credits in particular. On a positive note, though, in all three

cases bank resolutions were performed without causing any material systemic ripple effects.

The fund does not hold any of the three failed banks and carries an underweight of Eurozone credits in general and Eurozone banks in particular.

## 0.2% behind benchmark

**The Portfolio** June's gross performance of -0.3% was 0.2% behind benchmark (-0.1%). Year-to-date gross performance amounted to 1.9%, which was 0.5% below benchmark (2.4%).

It is no surprise that the fund's performance in the first half of 2017 somewhat lagged the benchmark. The fund is positioned defensively to weather and possibly exploit sell-offs related to the Eurozone's fundamental economic and political challenges mentioned in the markets paragraph. So, in a Eurozone rally, the portfolio is expected to underperform somewhat. The shortfall risk is reduced by the fact that absolute effective yields in this part of the Investment Grade universe is already averaging less than 1% with a duration above six. This limits the scope of how much further absolute yields and spreads can drop, in our view. In addition, the ECB is likely to reduce its monthly purchases of Eurozone credits, if this blue-sky scenario continues.

In June, we increased existing holdings in the US retailer, Bed Bath & Beyond, the US transportation and logistics company, United Parcel Service, and the global industrial conglomerate, General Electric. We added no new names through June. Divestments included a reduction in the Finnish electrical power producer, Teollisuuden Voima (TVO), and the US Bank, Morgan Stanley.

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## Strategy

Investment Grade Value Bonds invests in global corporate bonds, cf. the fund's prospectus. Bond selection is based on the value approach, meaning that the team focuses on bonds issued by companies with healthy long-term earnings power and strong balance sheets as well as an expected ability to service outstanding debt. The portfolio is diversified across sectors, regions and credit ratings. At least 2/3 of the portfolio are invested in Investment Grade bonds.

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