

## Investment Grade Value Bonds

FIXED INCOME

## Discounted Deutsche Bank added

## Financials underperforming

**Markets** Volatility increased in September triggered by concern about the future path of the monetary policy, especially in Japan and in the US, but also at the ECB. The FED decided to postpone a hike, which the market now look to price in at either the November or December meeting with about a 60% likelihood.

Credit markets were burdened by Deutsche Bank being presented with a USD 14bn fine from the US Justice Department related to events leading up to the subprime crises about 10 years ago. This month, the stock fell by about 20% and the bank's subordinated bonds suffered as well, spilling into the pricing of other Eurozone banks. Thus, financials underperformed non-financials, dragging down September's benchmark return to minus 0.3% in spite of slightly lower interest rates. Year to date benchmark return stands at 7.22%, stemming from both spread tightening and dropping interest rates.

A few days into October, the Deutsche Bank upset toned down significantly, the stock regained almost two thirds of the lost territory and the same pattern of recovery benefited the subordinated debt instruments.

## 0.2% outperformance

**The Portfolio** September's gross performance of -0.1% was slightly better than benchmark of -0.3%. Performance attribution was broad based with no particular segments standing out.

Year-to-date the gross performance of 7.2% is on par with benchmark in spite of having a lower level of duration in the

portfolio (about 5) versus the benchmark (about 6) during Q1 2016 where interest rates fell significantly. During H1 2016, the duration mismatch resulted in an opportunity cost of approximately 1.0%. We aim to keep future duration mismatch low, so it no more materially can influence relative performance.

Through September, the regional weights were stable in the portfolio: North America staying at 51%, Western Europe increasing to 31% from 30% and Asia/Pacific resting at 12%.

Prior to the Deutsche Bank initiated unrest, the portfolio was clearly underweight Eurozone banks (0.5% versus 5.8%) and had a zero-exposure to Deutsche Bank. On the back of this, we were able to buy a shorter dated bond from the safe part of the capital structure in Deutsche Bank at excessively discounted levels and, at the same time, reduce the underweight of Eurozone banks to 3 percentage points from 5 percentage points. The new position has already contributed positively to performance. Due to the European common currency and the European Banking Union including and the centralized supervision and regulation, the largest systemic Eurozone banks increasingly represent one closely-knit risk. Thus, the overall underweight of Eurozone banks effectively mitigates the risk associated with the position in Deutsche Bank.

The ability to exploit this opportunity owes to the defensive nature of the portfolio. Thus, the focus on capital preservation in a low interest and now spread environment goes hand in hand with the ability to take advantage of sell-offs not supported by fundamentals.

See performance and fund data [Click here >](#)

## 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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