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MIRABAUD – GLOBAL STRATEGIC BOND FUND

NAVIGATING A COMPLEX ENVIRONMENT TO DELIVER A LOWER-RISK GLOBAL FIXED INCOME STRATEGY

Q&A WITH ANDREW LAKE, HEAD OF GLOBAL FIXED INCOME AT MIRABAUD ASSET MANAGEMENT

CAN YOU DESCRIBE YOUR APPROACH?

We launched the Fund in 2013 and since then, managing risk has always been a priority. This is an unconstrained bond strategy that takes a dynamic macro-focus, investing across all global fixed income sectors. Given our flexible focus in shifting sector and duration allocations, we have a highly structured and disciplined process to deliver strong risk-adjusted returns with managed liquidity and controlled volatility.

Over time, we expect around two thirds of returns to come from top-down asset allocation and the balance from duration and credit selection. In keeping with our approach to manage risk, duration has normally been in a range of 3-4 years

An example of our priority on risk at work is how we approached entering 2020. We entered the year in a 'V' shaped recovery following the resolution of the US/China trade deal. However, we remained cautious about the sustainability of any recovery and so refrained from adding risk in areas of fixed income we saw as overvalued – we did not want to chase yield at any price. As a result, the Fund was defensively positioned before we entered this period of extreme market volatility. As risk assets slumped in February and during the first half of March, we were well positioned with high levels of cash and cash-equivalents.

> We have a highly structured and disciplined process to deliver strong risk-adjusted returns

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The markets seem to be stabilising somewhat, with optimism that the global shutdown is going to be of short in duration, with limited long-term damage. However, we continue to be driven by the uncertainty of the longevity of the virus, and until that unknown is alleviated, volatility will be here to stay. As a result, we'll remain more defensively positioned in the short term.

We will add risk when we feel the time is right and we feel that we'll be getting the right amount of return for the risk. Our base case at this point is still that we see two quarters of negative economic growth, and then a recovery in the fourth quarter of 2020 as the virus dissipates. If we take a 12-month view, our conviction is very high that we will have positive returns in fixed income generally, and high yield in particular, over that period.

HOW DOES THE SPREAD SELL-OFF COMPARE TO THE FINANCIAL CRISIS IN 2008?

It took nine months in 2008/09, during the global financial crisis, to register the same degree of fixed income market sell-off that took only three weeks in March 2020. Despite the obvious differences between the financial crisis of 2008 and the economic crisis in 2020, a number of factors were at play this time, which had a significant impact on global fixed income markets.

Oil: The economic and financial market challenges were compounded by significant weakness in the oil price. Consequently, Emerging Market debt was particularly impacted given the dual effects of both the US dollar and the collapse in oil and other natural resources.

US Treasuries: This time, selling pressure was indiscriminate across all sectors of the fixed income market. In mid-March even Treasuries were under pressure as the financial system came under significant pressure. The resultant 100bps tightening and then widening the US 10-year and 30 year Treasuries in less than one week was unprecedented as investors rushed into cash.

Going forward it is likely that Treasuries will widen given the need for huge issuance to pay for the huge spending programme announced by the US government.

ETF's: Another key different that has characterised this sell-off is ETF's, which are now a significant part of the market compared to 2008. ETF's put considerable pressure on liquidity in the market – they are price takers and as such drive the markets down with outflows and up with inflows. This "investing/divesting at any price" adds to broad fixed income market volatility, particularly during times of illiquidity and stress. It also reinforces why it's important to take an active, flexible approach when markets remain volatile, or when default rates or downgrades are likely to increase.

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HOW HAS THE HIGH YIELD MARKET BEEN IMPACTED?

At the height of market volatility in March, High Yield suffered the largest impact as a result of illiquidity, with spreads widening to around 1000 basis points, before posting a strong recovery in the latter part of the month. However, we do expect default rates to increase in this challenging economic environment, and some market participants are forecasting this to be somewhere in the region of 8-10%.

We also anticipate downgrades from Investment Grade to High Yield – this will place additional pressure on the High Yield sector, given that current poor liquidity. As a result, we have added a 15% CDXHY short position on the Fund.

Around one third of our exposure in the Fund are in maturities below one year. This gives the Fund a natural source of liquidity and flexibility in this environment. When these credits mature, we'll reallocate into high quality Investment Grade or cash and cash equivalents, limiting our exposure to the High Yield sector.

DO INVESTMENT GRADE CREDITS OFFER VALUE IN THIS CURRENT ENVIRONMENT?

In the investment grade space, high quality investment grade credits were impacted by the dash to cash as this sector of the market was the most liquid. This opens up opportunities for us to build positions in high quality credits with strong cash flow and balance sheets.

As a result, we'll be opportunistic and taking advantage of deeply discounted levels in some of the higher-quality investment grade credits by incrementally adding smaller position sizes – we believe that averaging in this environment makes sense.

An additional layer of support comes from the US Federal Reserve's backstop programme for corporate bonds, which was introduced in March as mutual funds experienced significant outflows. The lack of liquidity during March meant that Investment Grade ETF's came under significant selling pressure, leading to large swings in prices. This provides a level of technical support to the investment grade sector in the US.

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HOW WERE WE POSITIONED INTO Q1

- We entered 2020 on a cautious note despite the trade deal agreement between the US and China, which was actually viewed positively by the market
- We maintained our defensive positioning
- We refrained from chasing yield at any price – resulting in lower positions in High Yield and Emerging Market debt
- As the market environment deteriorated, we extended our short duration position and kept cash and cash equivalents (US Treasuries) high

WHAT WE THINK IS COMING

- We expect default rates to increase across both Investment Grade and High yield as many companies won't survive despite fiscal and monetary support from governments. Some market participants are forecasting High Yield default rates of 8-10%
- There is technical support for asset backed securities and investment grade bonds as a result of the QE programmes in place by the US Federal Reserve
- High uncertainty continues to characterise the market but there are selective value opportunities
- Liquidity remains challenging in the short term and we want to be comfortable with the sustainability of recovery before adding risk-on

HOW ARE WE POSITIONED FOR THE FUTURE

- We are focusing on high quality
- We maintain our cash and treasury positions on the basis that we will be heading into a period of challenging economic data
- We are selectively building holdings in better quality investment grade credit
- We have added a 15% CDXHY short position on the Fund as high yield bonds remain fragile
- Around one third of our holdings in High Yield are in maturities below one year. This gives us a natural source of liquidity – for example, 2-3% of our holdings mature each month, which means we can deploy this cash into other opportunities

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