FIXED INCOME MARKET UPDATE

MIRABAUD Asset Management

MIRABAUD ASSET MANAGEMENT'S HEAD OF FIXED INCOME, ANDREW LAKE, PROVIDES AN UPDATE ON FIXED INCOME MARKETS, AS WELL AS ON OUR RANGE OF FIXED INCOME FUNDS.

We have begun to reduce the duration of cash bonds across **Mirabaud - Global High Yield Bonds** and **Mirabaud - Global Strategic Bond Fund**, taking advantage of the recent risk off mode with the 10year Treasury back at 2.80%. If we are correct, and begin to see inflation coming through again in the US, we believe that the US 10 year Treasury can revisit +3% before the end of the year. In that instance, we feel that there is more pressure to come on low coupon bonds in the 5-7 year maturity range.

We would also emphasise the fact that the key driver of most of the negative performance from bonds this year has been from the aggressive move wider in the US Treasury yield curve over the first couple of months of the year. It is unlikely that we see another 100bps of widening in such a short space of time barring an inflation shock, so we believe that fundamentals should begin to reassert themselves as the drivers of performance. The clear short-term issue that continues to delay this is the spectre of a global trade war. Having said that, the path of interest rates in the US is clear: the market is pricing most, if not all of them in, the global economic growth story is intact, and inflation is generally low. With all of this in mind there is little reason to panic about Fixed Income as an investment opportunity.

Again, as has been one of the main characteristics of the year so far, fundamentals no longer matter at this point. It is all about the next Tweet on trade from President Trump, and all eyes are looking towards the 6th July when the first wave of tariffs on Chinese goods comes into being. The market is still not pricing in a trade war at this point, so there is significant downside risk if this does begin to get out of control. On the positive side of the ledger, all of the recent US economic data is pointing to a more confident consumer, and rapid growth across the board. Bottlenecks are beginning to form in supply chains, and raw material prices are beginning to go up, both of which should begin to feed through to increased prices. We consider that the non-accelerating inflation rate of unemployment has been reached and we should begin to see more wage inflation coming through as well. Again, as I have said many times before, all of this is from a low base and it is very hard to see any signs of bubbles forming at this point. From a fundamental perspective we are some way away from having to worry about a recession. Where we do have concerns is over valuations, which do look very late cycle. Whilst the BAML USHY Index (H0A0) absolute yield looks interesting when compared to everything else, spreads at approximately 350bps are at the tighter end of the range, and we are very aware of that when positioning the Funds for the summer months.

On the whole, we have not made large scale changes. We have consistently explained our limited holdings of hard currency emerging market (EM) debt given valuations, and that has stood us in good stead during the recent sell-off. We also discussed a stronger dollar in our February note, and we still see that as a driver of EM underperformance in the shorter term. Whilst HY is expensive, we do not see a step change in its cycle, and so have only reduced risk as a tactical position, waiting for a better entry point if we see some volatility. We have begun to add short-dated investment grade bonds on a case by case basis in the US as well. We continue to shy away from Europe given our views on valuations, but there have been more opportunities coming through in HY given the recent sell-off on the back of the Italian election.

GLOBAL HIGH YIELD BONDS

Mirabaud - Global High Yield Bonds (GHY) has been fairly active over the last 4-6 weeks. We have raised cash to just under 10%, we have reduced or taken profits on a number of positions which react more to the market than idiosyncratic triggers, and have also invested in some very short duration, high coupon credits. We have persevered with the US Treasury hedge. Whilst this is a net negative at present, due to the risk off as a result over trade wars, we still feel it will make a positive contribution to returns by year end. We are also light on EM exposure, which is another area that has been under a lot of pressure. June was another choppy month, but the Fund did manage to navigate the volatility successfully both versus the general market and peers.

US SHORT TERM CREDIT FUND

Mirabaud - US Short Term Credit Fund has also reduced duration to a certain extent, and has invested in those companies where we feel the yield is very attractive for the foreseeable future. Again, the US Treasury hedge remains in place given our view on where the economy is going, but irrespective of this, the Fund continues to gradually improve given the more stable Treasury curve. Emerging Markets exposure is also light, but given the short maturity nature of the Fund, asset allocation has a much smaller significance that it does in the other funds.

EXPERIENCED INVESTMENT TEAM

ANDREW LAKE – HEAD OF FIXED INCOME

Andrew joined Mirabaud Asset Management in 2013 and has over 20 years' experience in fixed income, covering strategic bond and high yield products.

GLOBAL STRATEGIC BOND FUND

Mirabaud - Global Strategic Bond Fund has also been more cautious given where valuations are at present. We have added short duration bonds, but for the most part have been happy to sit with the hedge in place and a large position in short maturity Treasuries and Treasury Inflation-Protected Securities. We have also added some high coupon, short maturity HY where appropriate. Recent negative performance has been primarily driven by investment grade bonds and financials. Some of this was offset by High Yield, and the Treasury exposure, which did relatively well.

OIL AND THE ENERGY SECTOR

We have been fairly active in the energy sector. We increased exposure on the GHY Fund to approximately 17% in April, anticipating a further geo-political boost to the price of oil. We then took profits and took the weighting down to around 10% and emphasised gas over oil. The Permian is suffering from capacity constraints given the limited pipeline capacity and thus margins are not increasing with the price of oil given the increased transport costs. We continue to believe that the price of oil will remain at around $65 given the demand/supply situation, but given the elasticity of demand to price if we do go further than $75 on WTI we could see some re-balancing of this.

EUROPE AND THE ECB

We continue to believe that the risk/reward is skewed to the downside, even with the cost of the USD hedge. The benefits of the weaker Euro should begin to come through and we believe that data in Europe will begin to improve thus pressuring Bunds to move higher. The ECB has made it clear that interest rates will not move up for at least a year, but there is the risk that either the ECB is behind the curve, or the US ends it rate hiking at just the time Europe begins. Either way there is the risk of a big move wider in Bunds as we saw with Treasuries this year.