COVID-19 INVESTMENT UPDATE: STERLING EXTRA YIELD – 30 MARCH 2020

Performance

The fund has performed in line with higher yielding funds and markets. While longer term performance is favourable, recent performance has been negatively impacted by the sell-off in risk assets. March month to date (25 March) fund performance is -18.1% (-17.2% year to date), while that of the broader sterling investment grade credit market is -7.0% (-4.7% year to date) and sterling hedged euro and global high yield are –16.7% and –18.4% (-17.9% and –19.4% year to date) respectively. Last week, the fund and the various market indices posted small turnarounds.

Markets

March month to date, market yield spreads have widened significantly across all market sectors and for all grades of credit quality. These moves have few parallels; the prior week's moves in investment grade spreads were greater than the spread widening in the whole of the month of September 2008 during the Global Financial Crisis, with returns to suit, and the single day move of 100bps in high yield spreads on 19 March was the third largest single day move ever, behind only 9/11 and the day that Lehman filed for bankruptcy.

Credit Spreads

What do credit spreads mean for investment returns in High Yield? Widening credit spreads is an indication of reduced liquidity in the market, increased volatility in the market, or worsening economic conditions. It's important to focus on which direction spreads are moving rather than the overall size of the spread. For example, credit spreads reducing from 800bps to 500bps would indicate strong performance for High Yield Bonds as it's perceived these Bonds have reduced in risk in comparison to Government Bonds. However spreads increasing from 300bps to 500bps would indicate negative returns for High Yield. In both cases the spread is 500bps, but it's important to focus on the movement to get to that figure. Since the beginning of the market downturn, spreads have increased from around 350bps to over 1000bps. This creates a buying opportunity for those expecting spreads to tighten as markets recover.

Portfolio Activity

The fund remains biased towards secured cashflows and on delivering a high level of income. However, the focus of activity over the month to date, as it has been across all of our credit funds, has been on building and maintaining liquidity in order to service fund flows while not altering the fundamental investment approach or strategy of the fund. Liquidity has been and currently remains challenging, with considerably wider bid-offer spreads in many of the securities in which the fund is invested and would look to trade. However, liquidity has been successfully accessed and flows serviced without impairing the long-term income generation of the fund.

Outlook and Strategy

Interest rates are likely to remain very low for some time, and growth prospects lowered, with government bond markets pricing accordingly. While initial market reflections on inflation (especially after the oil price move) were negative, the longer term outlook is far different. Elevated volatility is expected to continue and credit yield spreads are expected to remain wider until confidence is regained but there are already signs of this. Although markets could deteriorate further in the interim, we are well positioned to benefit from a recovery in credit markets when they happen.

We believe the portfolio is robust, with a focus on credit fundamentals; maintaining our medium to longer term philosophy-based approach, resulting in an emphasis on security and income, continues to be the best way of navigating the current environment through to market recovery. However, liquidity management is important; market liquidity across all asset classes is reduced and pricing challenging, and we are focused on maintaining the integrity of the portfolio, including servicing any disinvestments and treating all investors fairly, without changing the fund's fundamental investment approach.

Please note that this is a fast moving environment and markets and impacts on portfolios are changing. Opinions contained in this document represent views of our fund managers at time of writing, and performance numbers are estimates and not audited.