

## Quarterly Review (As at 30 September 2019)

# New Capital Euro Value Credit Fund

**Q3 2019**

FIXED INCOME



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Senior Fund Manager

### Overview of the Quarter

The third quarter of 2019 proved extremely positive for the European credit market, which benefited mainly from the decline in interest rates and from the stable environment on corporate bond spreads.

As a reference, the quarter ended with the German yield curve at negative levels on all the maturities: 10-year bonds decreased by 25 basis points closing at -0.57%, and 30-year bonds followed suit reaching -0.07%. Spreads on investment grade bonds stayed relatively firm around 110 basis points over the quarter and speculative grade traded in the 375 basis point area, generating total returns on the asset class of 1.31% and 1.29% respectively.

The Fund took advantage from the general environment, delivering a gross performance in line with the market, with a positive contribution from carry, interest rate exposure and credit spreads.

### Performance and Positioning

The European credit market has been impacted by many factors over the summer months, but three have been particularly relevant in driving total returns.

First, weakness in global economic data has been a major source of concern over the quarter as the main forward-looking indicators have pointed to sub-par growth for the rest of the year. In Europe, this was more pronounced in the manufacturing sectors, with PMIs well below the 50 thresholds, while the services sector seemed more resilient to the downturn.

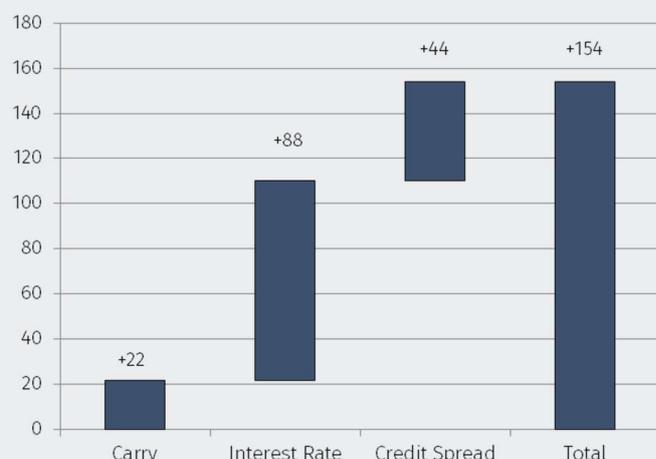
In this context, central banks reacted promptly with a round of rate cuts. The Federal Reserve cut its reference rate by 50 basis points, while the ECB followed suit delivering a compressive package including a 10 basis points deposit rate reduction, measures to improve bank liquidity and strengthen forward guidance.

European interest rates dropped dramatically, and the yield curve flattened in anticipation of the new round of measures to boost growth and ease monetary conditions. The Fund benefitted from these changes and rates contributed to the performance by 88 basis points in absolute terms.

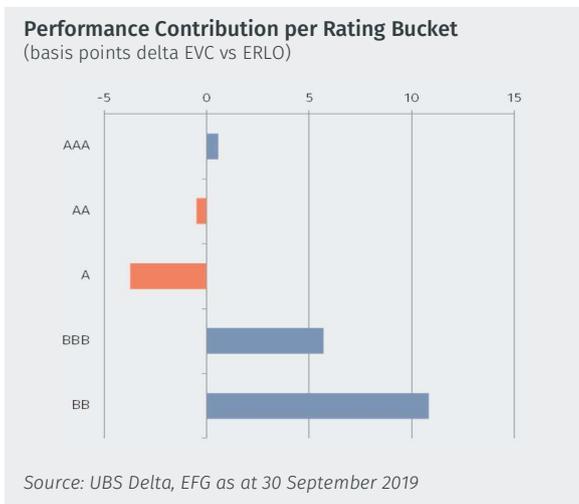
As a second theme, political risks have generally continued to be a reason for concern, although they didn't have a dramatic impact on the European credit market. In the UK, Brexit talks have continued under the leadership of Boris Johnson, but a solution with the European Union has not been reached so far. Italy, on the other side, experienced a government crisis in August which led to a reshuffle in the coalition partners. Outside Europe, the trade war between the US and China remained on the radar and the Middle East proved another source of geopolitical instability.

In general, the Fund maintained a low exposure to these risks, with modest holdings on Italian corporates, zero exposure to the UK and selected investments in emerging markets. Country allocation was a driver of performance also this quarter, but individual contributions proved less relevant compared to the recent past.

### Performance Attribution



Past performance is not necessarily a guide to the future  
Source: UBS Delta, EFG as at 30 September 2019



As a final consideration, yield hunting has continued to be a major driver, with investors forced to move longer in duration and lower across the rating spectrum to pick up yield. The Fund took advantage of this trend investing in the BB rating category through subordinated securities issued by corporates with strong fundamentals.

On the other side, idiosyncratic risks have increased, especially among high yield corporates, making issuer selection an even more delicate topic. Concentrating holdings in a relatively small number of high conviction exposures proved particularly efficient in this respect.

**Outlook**

Most of the macro themes mentioned above have the potential to continue being key drivers for interest rates and credit spreads over the next months.

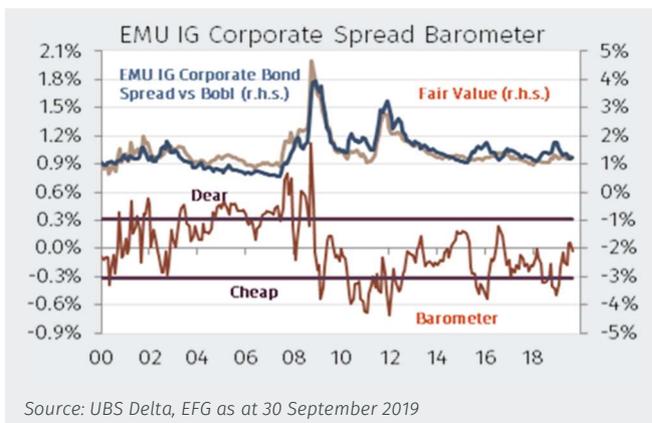
The current stage of the economic cycle is one of the major sources of concern. Although a recession seems unlikely, with growth slowing below trend it becomes crucial to monitor macroeconomic data and the direction of the global economy for the next quarters. In Europe this is a particularly sensitive topic, especially at a time when the ECB appears to have less room for monetary easing.

As Mario Draghi highlighted in a recent press conference, more is expected from fiscal policy, especially from those countries like Germany where surplus is still large and offers some opportunity to increase investment spending.

On the political side, a few themes are still on the table and could drive price action over the next months. Brexit and US-China trade discussions are clearly the hot topics, but also the sanctions against Iran and the geopolitical tensions in the Middle East area could impact on the oil price.

At current levels, corporate spreads look in line with historical averages and valuations are close to fair value in our opinion. The overall picture is supportive and highlights stable fundamentals within most sectors and individual names; traditional credit metrics like leverage ratios and earnings growth showed a relatively stable path and M&A activity remained quite muted in Europe.

From a technical perspective, demand and supply look quite balanced at this point: new issuance activity is expected to moderate in the fourth quarter after the summer spike, while appetite among investors is rather persistent and showing few signs of moderation.



Note: Past performance is not necessarily a guide to the future. Returns may increase or decrease as a result of currency fluctuations. Performance is net of fees. Please refer to the Prospectus for further information on this Fund and prior to any subscription.

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