

Global Credit Income

Quarterly Review and Outlook

As at June 2016

Key Highlights

- Global credit spreads largely moved a little tighter over the quarter despite widening towards the end of the period due to the uncertainty in markets and risk-off attitude as a result of Britain's vote to leave the EU.
- Credit valuations appear favourable from a longer term perspective.
- Fundamentals remain generally supportive of tighter credit spreads and current spread levels present an interesting entry point from a valuation perspective.

Market Insights

Global credit spreads largely moved a little tighter over the quarter despite widening towards the end of the period due to the uncertainty in markets and risk-off attitude as a result of Britain's vote to leave the EU. The Barclays Global Aggregate Corporate Index average spread moved 4 bps narrower in the quarter, closing at 1.54%. The Barclays US Aggregate Corporate Index average spread finished the quarter 7 bps narrower at 1.47%. In contrast, the Barclays European Aggregate Corporate Index widened by 6 bps to 1.37% which is to be expected given they were notably impacted by the Brexit vote. In Asia, credit markets also moved narrower with the JPMorgan Asia Credit Index (JACI Composite) average spread in 15 bps to 2.72%.

US High Yield credit spreads moved notably tighter in the quarter with the Bank of America Merrill Lynch Global High Yield index (BB-B) spread 39 bps narrower, closing at 4.99%. Spread tightened early in the quarter as a risk-on sentiment in markets was driven by a rise in oil and commodity prices. As per the rest of the bond market, spreads then widened in June as a result of Brexit uncertainty changing market sentiment.

Issuance in investment grade credit started strong in the quarter with large deals in Europe and the US specifically. New issues were likely driven by investors seeking additional yield given negative interest rates in Europe and Japan and continued low interest rates in the US and UK. Inevitably issuance fell off the cliff in the run up to the British referendum. Issuance immediately up to the vote was at the lowest levels year-to-date. However, signs of life did return towards June month end with some light issuance and liquidity; a potential sign of the market's ability to cope better with shocks.

Strategy Positioning

The strategy returned 0.96% (net of fees) during the quarter, whilst the benchmark returned 0.11%.

The strategy running yield remained supportive of performance as did the mild narrowing in credit spreads in the quarter.

Credit Market Outlook

Credit valuations appear favourable from a longer-term perspective. While spreads had narrowed markedly from GFC wides and had fallen to levels where valuations were neutral at best, the widening throughout 2015 has seen value again become attractive relative to history. Valuations remain attractive on a long-term perspective and credit spreads at current levels are attractive enough for us to increase the overall credit beta in the portfolio.

Default rates continue to be relatively low (despite some recent increases from the energy and mining sectors due to the lower oil price), credit conditions remain relatively accommodative, and as a result, spreads currently overcompensate investors for credit risk incurred.

Record amounts of corporate bonds have been issued into the market by corporates looking to fund at, what appear to be for them, very attractive all-in yield levels. Against that, demand has been very supportive with many deal books multi times oversubscribed. This demand for corporate credit is likely driven by credit spreads now accounting for the larger portion of all in yields.

Fundamentals remain generally supportive of tighter credit spreads and current spread levels present an interesting entry point from a valuation perspective. Defaults are likely to increase throughout 2016 driven by the energy and metals/mining sector.

Business Update

Prior to month end, the Global Fixed Income and Credit Team was restructured in order to be make the business more responsive to the changing needs of markets and clients. As part of the restructure some members of the previous team left the business, including the Head of Global Credit and Fixed Income, Tony Adams.

The management of our Global Credit offerings will be realigned under the leadership of Tony Togher, Head of Short Term Investments & Credit, together with his existing responsibilities leading the Short Term Investments team.

The day-to-day management of the Global Credit portfolios will continue to fall under the existing portfolio manager, Craig Morabito,

who will work alongside the credit managers in the Short Term Investments team. This move is a natural extension of the team's existing mandate focus and will create synergies for both capabilities.

These changes do not impact the strategy objectives including long-term return expectations.

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