Impact of Normalisation on Credit Markets

November 2018

Rate Hiking Cycles and Risk Assets

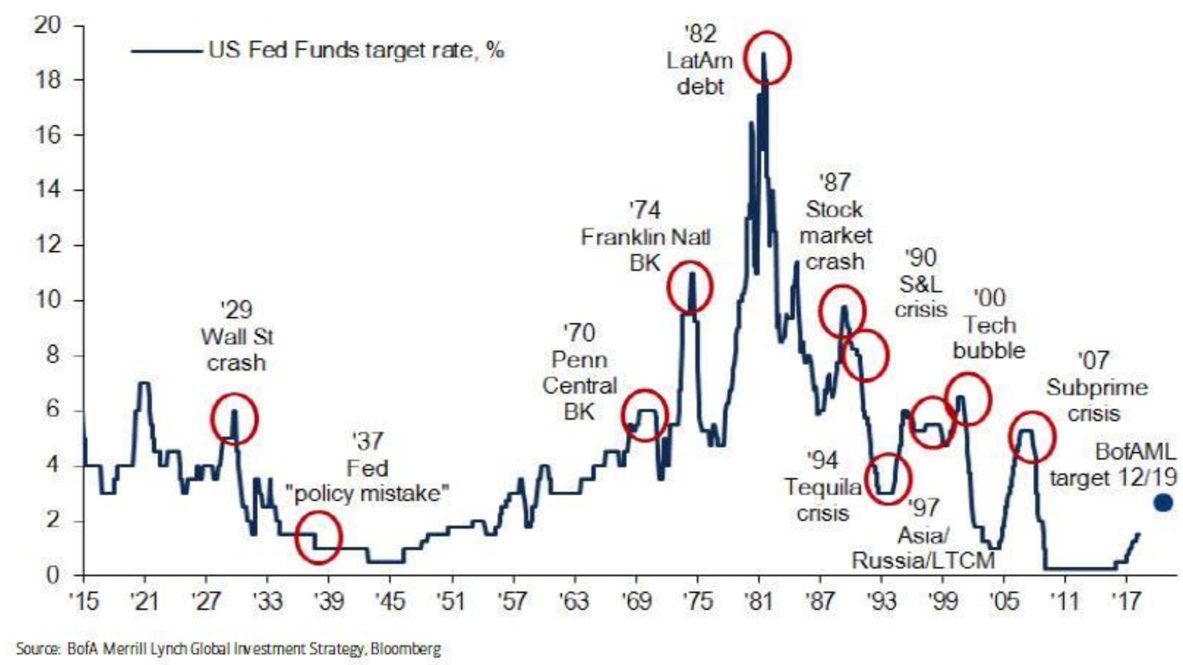
When a rate hiking cycle creates a tightening in financial conditions (higher real rates with respect to growth), a meaningful correction in risk assets often follows. The impact of higher rates on financial conditions typically occurs with a lag – depending on how long it can take for increased borrowing costs to impinge on growth and growth expectations.

Calibrating US monetary policy has arguably never been more challenging. The scale and timing of Trump's fiscal stimulus package has left the Fed's task of finding an appropriate level of interest rates (that balances price stability with financial conditions) - fraught with difficulty.

Allied to this is the great unknown that is quantitative tightening: the untried and untested process of unwinding the Fed's ~$4 trillion balance sheet and its potential impact on market liquidity. Accordingly, we believe the risk of a market correction from Fed tightening continues to grow.

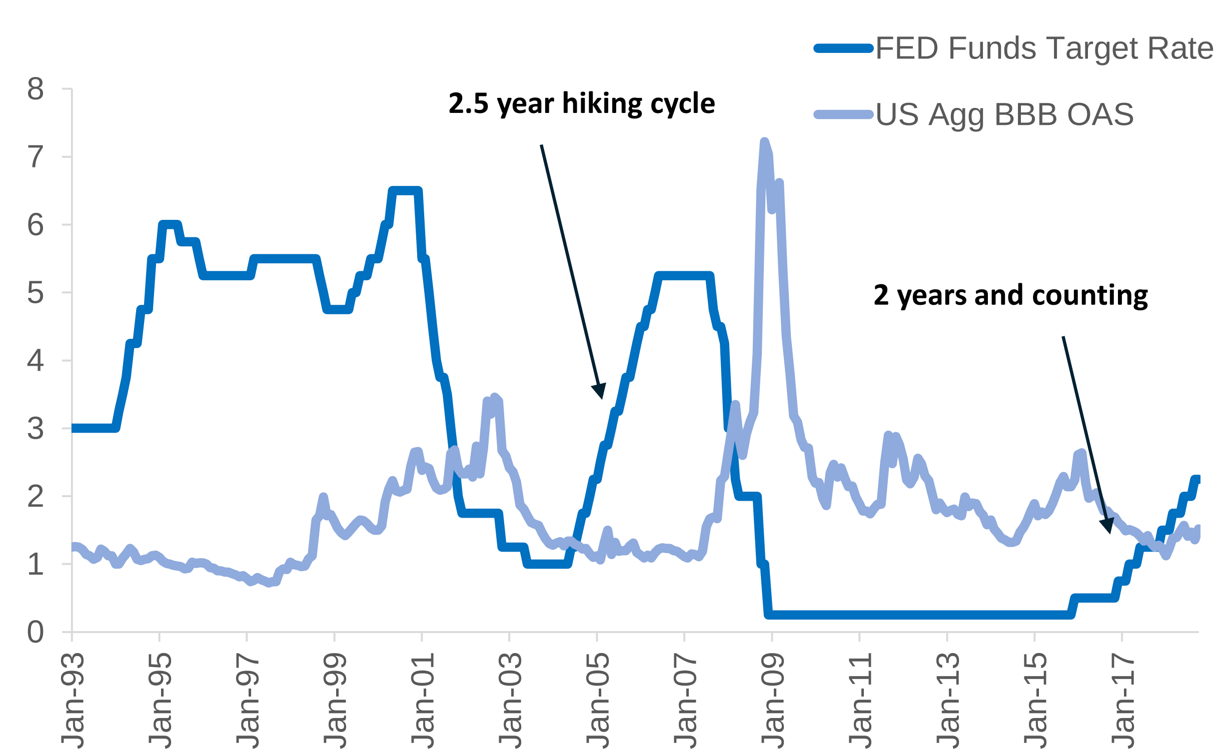
In spite of the numerous political headlines affecting short term sentiment, it is longer term financial conditions which we believe will be the real driver of volatility and returns. Whilst there are undoubtedly risks to credit investing today, there are also great opportunities for active managers to build out returns.

Previous Fed Tightening Cycles



Source: BofA Merril Lynch

Fed Funds Target Rate and Credit Spreads



Source: Rubrics Asset Management, Bloomberg

Rubrics
Asset Management

Impact of Normalisation on Credit Markets

November 2018

Structure of the Bond Market

The structure of the corporate bond market has changed markedly in the years since 2008.

Whilst some of this has been driven by regulatory changes such as reduction in banks' corporate bond inventories, impacting secondary market liquidity; much is a direct result of monetary policy post 2008 - lower yields, increased risk appetite, longer duration issuance etc.

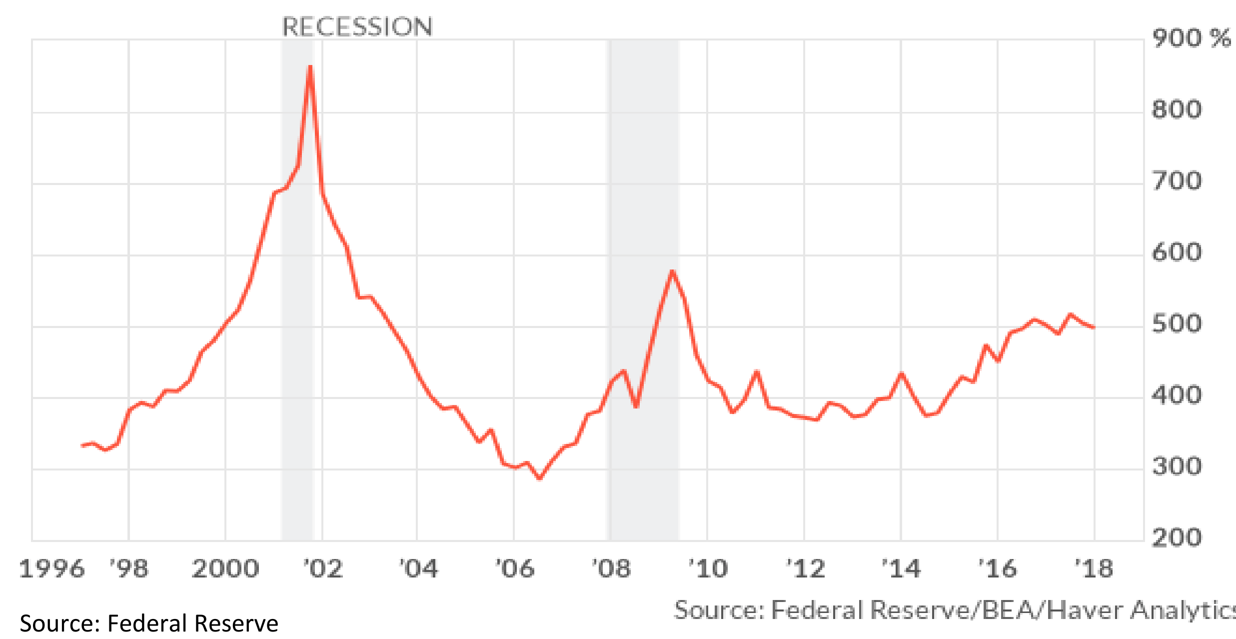
Current levels of corporate leverage are high – with plenty of debt issuance for buy backs, and not a whole lot for investment in future profit growth through capex.

The type of debt that has been issued is of a lower credit quality than that of previous cycles, with BBB rated paper making up a higher percentage of the corporate debt stack.

Similarly the average duration of investment grade corporates has increased as a result of lower rates and investor appetite.

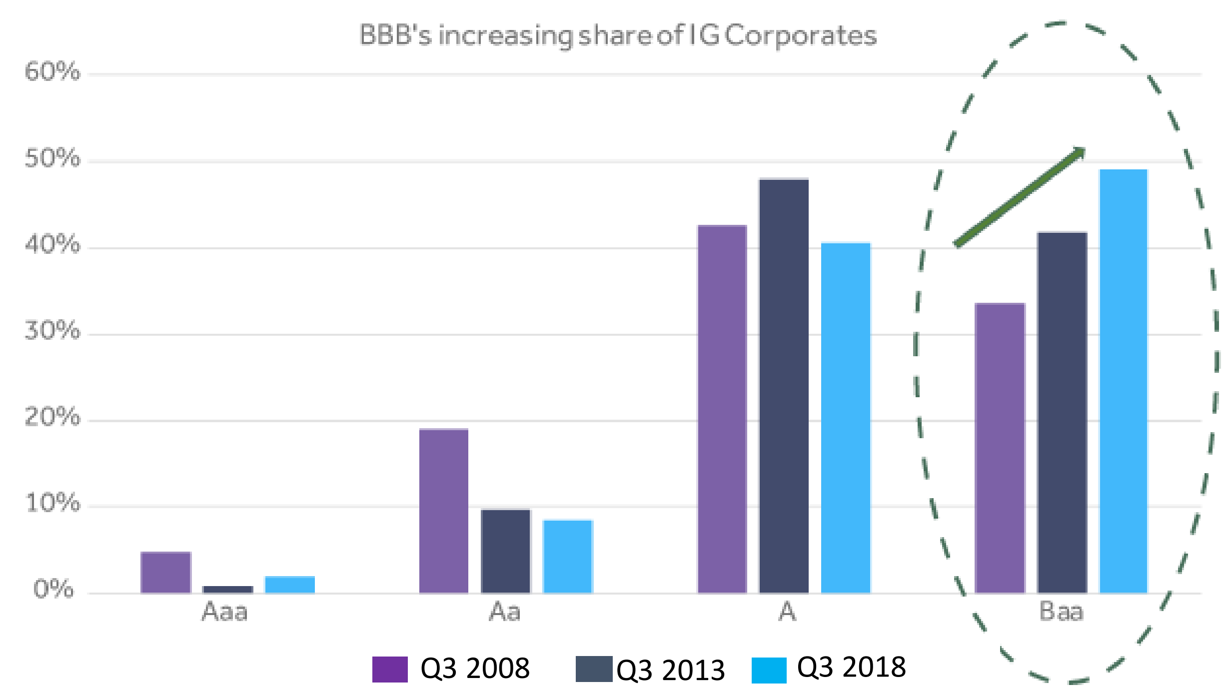
The upshot of this, is that corporate bond investors face more challenges in managing volatility than in previous cycles. Nonetheless active managers that can avoid the pitfalls of benchmark style investing will be well placed to capitalise on excellent investment opportunities that can arise from volatility.

Non-Financial Leverage Rising



Source: Federal Reserve

USD BBBs Share of Corporate Debt Rising



Source: BofA Merril Lynch

Average Duration of Corporate Debt Rising

Source: Rubrics Asset Management, Bloomberg

Corporate Bond Market Volatility 2018

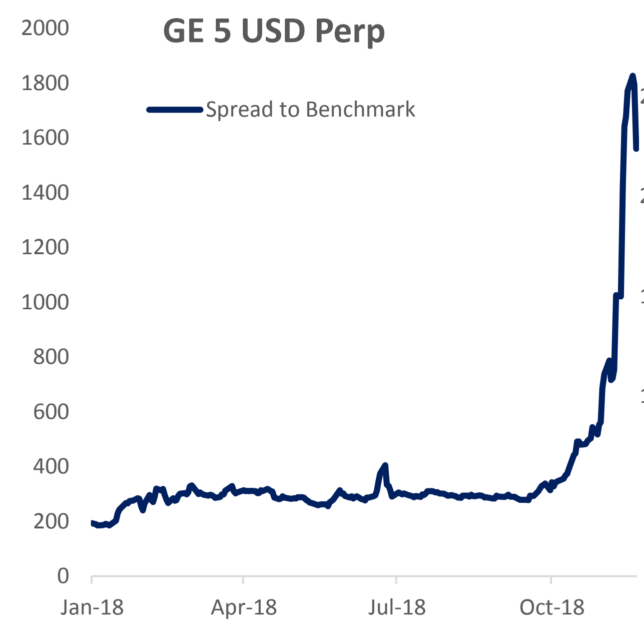
Poorly structured bonds with long maturities, low coupons, low resets and a shortage of covenants have led the way in what has been a difficult year for certain parts of the investment universe.

Declining profitability due to structural change, has impacted a broad range of industries. Within the retail sector, older store operators find it increasingly difficult to compete with online players.

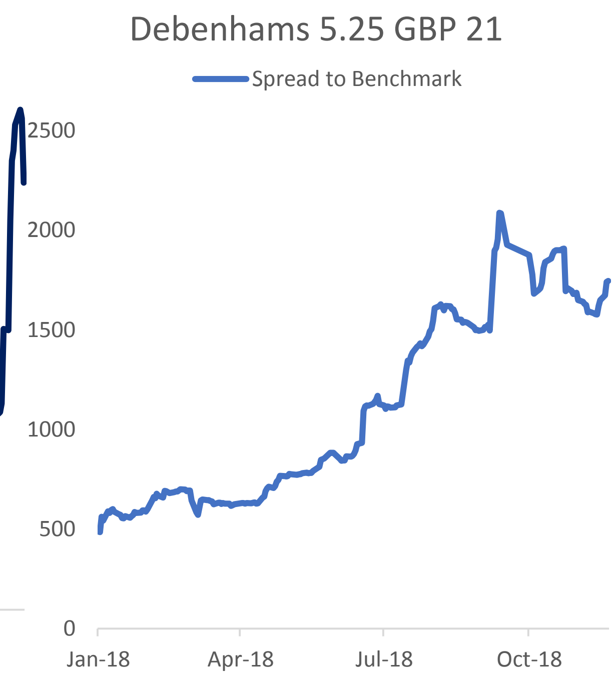
GE is a recent high profile example of a company struggling with a high debt burden against declining profitability within its traditional power generating business lines.

Regulatory change has become a big issue for traditionally defensive sectors such as tobacco which have seen considerable volatility this year.

Modest demand from China and Europe, rising capex spend on electric vehicle R&D and fines from ‘Dieselgate’ have weighed on spreads in autos and related sectors such as auto parts and chemicals.

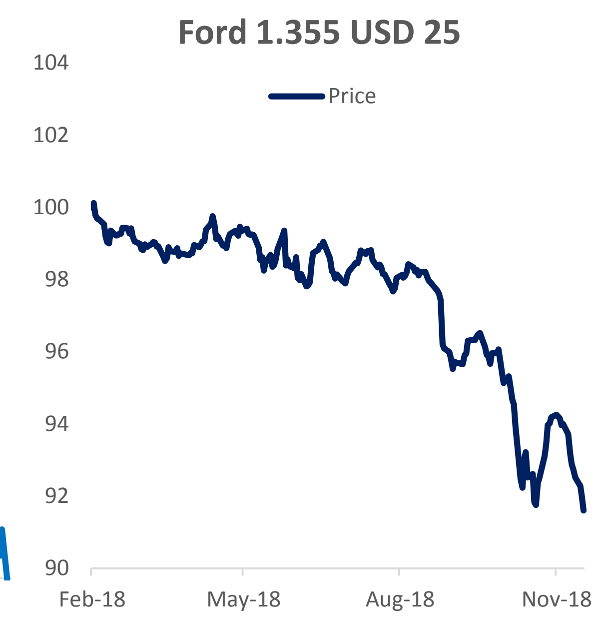


Source: Bloomberg as at 21/11/18



Source: Bloomberg as at 21/11/18

Source: Bloomberg as at 21/11/18



Source: Bloomberg as at 21/11/18

Ccy	Ticker	Issuer	Mid Price	Mid Yield	Price Return since issue
USD	AAPL 3.45 45	APPLE INC	86.91	4.3	-13%
USD	ABIBB 3.75 42	ANHEUSER-BUSCH INBEV	80.13	5.2	-19%
USD	CMCSA 3.4 46	COMCAST CORP	80.04	4.7	-19%
USD	BMW 2.25 23	BMW US CAPITAL LLC	93.12	3.8	-7%
USD	EBAY 4 42	EBAY INC	76.20	5.9	-23%
USD	F 4.75 43	FORD MOTOR COMPANY	76.55	6.7	-22%
USD	NESNVX 1.375 21	NESTLE HOLDINGS INC	95.56	3.2	-4%
USD	SBUX 3.75 47	STARBUCKS CORP	83.13	4.8	-17%
USD	ALVGR 3.875 PERP	ALLIANZ SE	81.57	4.8	-19%
USD	ISPIM 4.375 48	INTESA SANPAOLO SPA	70.95	6.6	-29%
EUR	VW 3 39	VOLKSWAGEN INTL FIN NV	86.75	4.0	-16%
GBP	WPPLN 2.875 46	WPP FINANCE 2013	75.11	4.5	-25%
GBP	HTHROW 2.75 49	HEATHROW FUNDING LTD	85.08	3.6	-14%
GBP	WELLTR 2.517 2118	WELLCOME TRUST LTD/THE	85.16	3.0	-16%

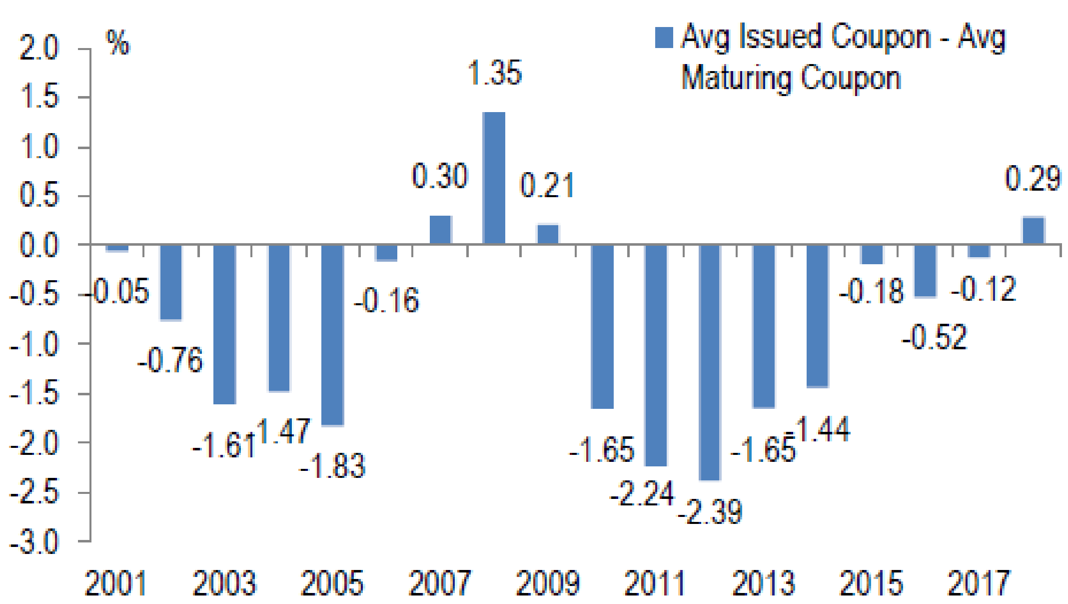
Source: Bloomberg as at 21/11/18

Corporate Bond Market Volatility 2018

Market volatility in Q2 and Q3 has led to postponement or cancellation of several new issues in equity and bond markets (see opposite). High yield issuers have been most impacted by not being able to issue at amenable levels.

In spite of the above, markets remain open for high quality borrowers, however they are having to pay up. 2018 has seen the coupons on new IG rated bonds exceed maturing debt for the first time since 2009.

Newly issued coupons vs maturing coupon pricing



Source: JPM

For those that can issue, the widest pricing appears to be in weaker sectors such as Autos, UK focused names (Brexit), Sub Financials and EM.

New issue concessions appear to be greatest in Emerging Markets. E.g. *China's Evergrande.* The $30bn market cap property developer raised 2yr USD paper at 11% - more than 300 basis points wide of its existing curve

Corporate defaults appear to be edging up in Europe, demonstrated by the first euro HY default in 14 months which occurred in October.

Cancelled Deals

AEGON – PNC 10.5 RT1

Whirlpool – 10 yr bond

TSB – 5 Year £ SONIA Deal

LafargeHolcim – Perp NC6 bond

TUI – 400mm €7yr bond

HUAWEI – EUR 5 Year Deal

lendlease – IPO & A$ bond deal

RENAULT – Sterling bond for RCI Banque

O2 – O2 UK IPO postponed

euroopt – Eurotorg London IPO postponed

airtel – London IPO for Airtel Africa

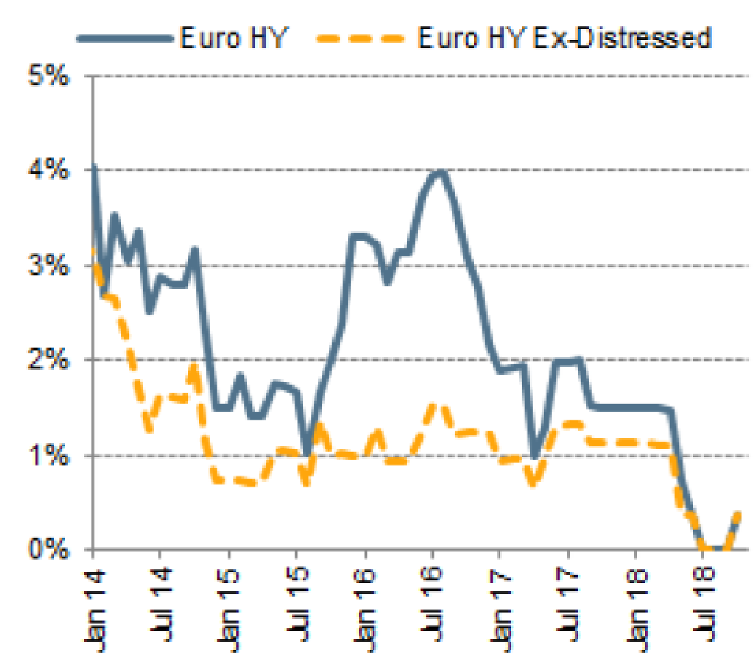
CEPSA – Cepsa IPO

中国工商银行 INDUSTRIAL AND COMMERCIAL BANK OF CHINA – $USD FRN

co op – GBP Sustainability Bond

Source: Bloomberg

Euro HY Defaults



Source: Creditsights

Careful credit selection has reaped benefits – Short duration bond strategies

The strategy of buying high coupon, high reset bonds from large enterprise value issuers has materially helped the fund returns.

In respect of callable issues, the above features (high coupons and high resets) has resulted in bonds being called at their first call date.

This feature enables a fund to build out a predictable maturity stream, while still benefiting from attractive yields.

The list set out opposite shows some of the issuers Rubrics have owned over the past two years, whose bonds have been called.

We continue to see attractive offers in select short call financials, as certain funds appear to be selling their low yielding/short duration instruments in order to create liquidity.

Security	Issuer
ACAFP 8.125 33-18	CREDIT AGRICOLE
ADNLN 7 PERP	ABERDEEN ASSET MANAGEMENT
AVLN 7.875 PERP	FRIENDS LIFE HOLDINGS
AVLN 8.25 PERP	AVIVA
BACR 8.25 PERP	BARCLAYS
BGGRP 6 ½ 11/30/72	BG GROUP
CKHH 3.75 PERP	HUTCH WHAMPOA
HSBC 8 2	HSBC HOLDINGS
INTNED 4.125 23 - 18	ING BANK NV
LLOYDS 6.461 PERP	HBOS CAPITAL FUNDING
OMVAV 6.75 PERP	OMV
RABOBK 8.4 PERP	COOPERATIEVE RABOBANK
RBS 13.125 22	ROYAL BK OF SCOTLAND
SLLN 6.75 PERP	STANDARD LIFE ABERDEEN
TELEFO 6.75 PERP	TELEFONICA EUROPE
UCGIM 6.375 23	UNICREDIT

Impact of Normalisation on Credit Markets

November 2018

Example of opportunities emerging in the IG credit space

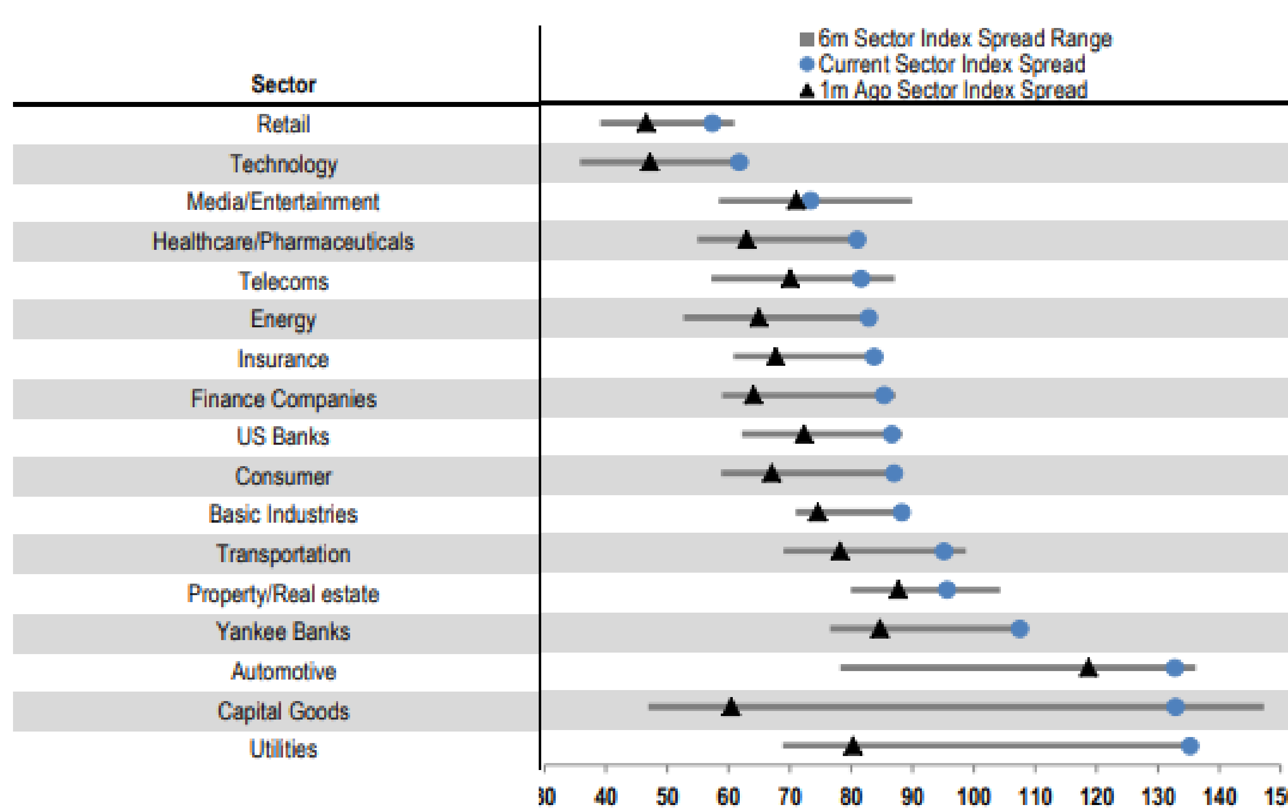
- Investors are being compensated more for owning risk compared to the start of the year.
- Attractive opportunities continue to emerge in large cap issuers, quasi sovereigns and national champions.
- Repricing has occurred through wider credit spreads and higher UST yields on USD bonds.
- An attractive yield pick-up exists on non-dollar G10 currency bonds when hedged back to USD.
- The rise in yields on IG rated bonds make high yield look expensive.
- Pull-to-par effect on “Roll-down” type bonds (typically <2 years, IG rated) can help subdue volatility.

Examples of yields on offer in IG Space

Ticker	Issuer	Current Yield ($)	OAS	Duration	Yield 31/12/17
Sub Fins					
INTNED 6 PERP	ING	7.5	469	1.3	4.2
EMGLN 5.875 24	Man Group	5.0	220	0.8	3.4
Corps					
BHP 6.25 75	BHP Billiton	4.5	164	1.8	3.1
EDF 4.25 PERP	EDF	4.0	123	1.1	3.8
FIDINT 6.75 20	Fidelity International	4.0	123	1.9	3.6
F 2.343 20	Ford Motor Credit	4.4	156	1.9	2.6
EM Quasi					
CNOOC 4.5 23	China Nat Offshore Oil Corp	4.2	133	4.2	3.2
EXIMBK 3.125 21	Export-Import Bank India	4.0	112	2.5	2.9

Source: Bloomberg, 21/11/2018

US IG Credit Spread 6 month Ranges (3 Year Curve)



Source: JPM Research

Rubrics Asset Management

IMPORTANT INFORMATION

November 2018

Rubrics Global UCITS Funds Plc is a variable capital umbrella investment company with segregated liability be-tween sub-funds; incorporated with limited liability in Ireland under the Companies Acts 2014 with registration number 426263; and authorised by the Central Bank of Ireland pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011, as amended). This document is for information only and does not constitute an offer or solicitation to deal, whether directly or indirectly, in any particular fund. Nothing in this document should be taken as an expressed or implied indication, representation, warranty or guarantee of performance whether in respect of income or capital growth. No warranty or representation is given as to the accuracy or completeness of this document and no liability is accepted for any errors or omissions that the document may contain. The Key Investor Information Documents ("KIIDs") and prospectus (including supplements) for Rubrics Global UCITS Funds Plc are available at www.rubricsam.com. The fund manager of Rubrics Global UCITS Funds Plc is Carne Global Fund Managers (Ireland) Limited (the "Fund Manager"). The Fund Manager is a private limited company, incorporated in Ireland on 16 August, 2013 under registration number 377914. Rubrics Asset Management Limited, located at 23rd Floor, 20 Fenchurch St, London, EC3M 3BY (Register number: 09492393) is an appointed representative of Shard Capital Partners LLP. Shard Capital Partners LLP is authorised and regulated by the Financial Conduct Authority (Reference number: 538762) and is located at 23rd Floor, 20 Fenchurch St, Lon-don, EC3M 3BY. Details can be found on the following link www.fca.gov.uk/register. Data Source: © 2016 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. www.morningstar.co.uk . For South African investors: In the Republic of South Africa this fund is registered with the Financial Services Board and may be distributed to members of the public. In addition to the other information and warnings in this document, the Financial Services Board of South Africa requires us to tell South African recipients of this document that collective investment schemes are generally medium to long-term investments, collective investment schemes are traded at ruling prices and can engage in borrowing and scrip lending and that a schedule of fees and charges and maximum commissions is available on request from the manager. Because foreign securities are included in the investments within this collective investment scheme, we are also required to dis-close to you that there may be additional risks that arise because of events in different jurisdictions: these may include, but are not limited to potential constraints on liquidity and the repatriation of funds; macroeconomic risks; political risks; foreign exchange risks; tax risks; settlement risks and potential limitations on the availability of market information. Additional Information for Switzerland: The prospectus and the Key Investor

Information Documents for Switzerland, the articles of association, the annual and semi-annual report in French, and further information can be obtained free of charge from the representative in Switzerland: Carnegie Fund Services S.A., 11, rue du Général-Dufour, CH-1204 Geneva, Switzerland, tel.: + 41 22 7051178, fax: + 41 22 7051179, web: www.carnegie-fund-services.ch. The Swiss paying agent is: Banque Cantonale de Genève, 17, quai de l'Ile, CH-1204 Geneva. The last share prices can be found on www.fundinfo.com. For the shares of the Funds distributed to non-qualified investors in and from Switzerland and for the shares of the Funds distributed to qualified investors in Switzerland, the place of performance is Geneva.

Rubrics Asset Management