EDMOND DE ROTHSCHILD

ASSET MANAGEMENT

SHOULD WE STILL BE **INVESTING IN BONDS?**

INTERVIEW - *April 2018*

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Bond markets are undergoing profound change. The returns seen since 2008 mainly resulted from falling interest rates and will be difficult to match without active investing and a precise grasp of the fixed income universe. At Edmond de Rothschild Asset Management, we believe there are still many opportunities but seizing them will require more rigorous selection of market instruments.

There are **numerous instruments which are better** equipped to deal with **a period of rising interest rates**

HOW DO YOU SEE TODAY'S MARKETS?

Bond markets are facing challenges: they are expensive, yields are very slim, and we cannot rule out the risk of interest rate rises. Our investment approach has integrated all these challenges, but we continue to think that there are still opportunities. After all, if markets are dear, it is for the very good reason that the macroeconomic climate is improving. In the eurozone, growth is picking up speed and GDP rose 2.3% in 2017, up from +1.8% in the previous year[1]. In the US, Donald Trump's election has not slowed investments and recent tax measures suggest they will continue to grow. And the three rate rises we expect this year in the US are a sign that the US economy is healthier.

At the same time, today's market environment requires strong diversification. Investors are concerned about fresh equity market volatility, cash is still beset with negative yields in Europe and alternative investments do not all come with the required liquidity. Steering clear of bonds would mean missing out on a number of diversified solutions designed to tap into the economic recovery.

Moreover, we should remember that the bond market is much more than one type of bond. There are numerous instruments which are better equipped to deal with a period of rising interest rates. However, they are not always accessible to private investors and require a thorough grasp of markets and a highly responsive investment regime. That is where EdR Fund Bond Allocation comes in.

HOW DO YOU ROLL OUT THIS INVESTMENT PHILOSOPHY?

EdR Fund Bond Allocation accurately reflects our investment philosophy: it takes an active and flexible approach to an investment universe which covers all bond market segments and seeks to best adapt to prevailing market conditions. The fund has triple flexibility. First, through the instruments used: by taking an overall view on bond markets, our experts pick the bond types they consider to be the most suitable for the current situation. Second, we also have considerable freedom over managing interest rate exposure; as a result, we can find opportunities from expected rate moves. Third, our issuer selection, the last stage in our investment process. To provide optimal coverage of all the opportunities in the universe, all our analysts take part in the selection process.

And as EdR Fund Bond Allocation is a core element in Edmond de Rothschild Asset Management's fixed income expertise, it offers investors a solution to volatile bond markets.

1. Source: Eurostat, Commission Européenne, 07/03/2018

WHICH SEGMENTS ARE YOU FOCUSING ON?

Credit, and particularly European high yield[2] bonds, continues to offer opportunities thanks to improving company fundamentals. We are particularly keen on subordinated financial debt as its fundamental environment (falling NPLs) and regulatory environment are both improving. And if interest rates were to rise, financial bonds should outperform other bond segments as bank profitability (and consequently their credit risk) would improve.
We are also convinced there are opportunities in peripheral European government debt. Thanks to strong economic momentum in the region and reduced political risk, some of these countries have been upgraded. Moody's, for example, raised Greece from Caa2 to B3 with a positive outlook in February 2018. The portfolio's biggest exposure is to Greece, Portugal and Catalonia.
In the interest of offering a diversified portfolio, we also invest in emerging country debt, inflation-indexed bonds and US investment grade credit.
And we have maintained high cash levels as we as convinced that we need to be ready to seize opportunities in today's environment as and when they arise. Our objective is not to advocate diversification at any cost but to remain selective and only invest when there are genuine reasons to do so.

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HAS YOUR INVESTMENT APPROACH BEEN SUCCESSFUL?

EdR Fund Bond Allocation now has more than €2bn under management for a diversified and international client base, a sign of investor confidence. We have earned this trust thanks to the fund's regular returns. As of 29/03/2018, it had returned an annualised 4.3% since the investment team change on 14/02/2013 and in spite of significant interest rate movements since the end of 2017. We are also particularly attentive to volatility which is running at 1.5% over a year and 3.8% over 3 years[3].
For more than 5 years, EdRF Bond Allocation has represented the first step towards building a diversified portfolio, posting the regular returns bond investors are looking for while constantly monitoring volatility.

2. High Yield: corporate bonds with a higher default risk than investment grade bonds but which pay out higher coupons.
3. Past performance and volatility is not a reliable indicator of future returns and volatility. AUM at 29/03/2018: €2.17bn. Data performance at 29/03/2018 for the fund's euro-denominated A share: Cumulative performance since the investment team change on 14/02/2013: +23.95%; A share 5-year cumulative performance: +23.90%; Performance of the A-EUR share from 01/01/2017 to 31/12/2017: +3.55%. A-EUR share volatility at 29/03/2018 : 1.5% over 1 year and 3.8% over 3 years. Source: Edmond de Rothschild Asset Management.

KEY POINTS

- Active and flexible allocation across all bond market segments
- A broad range of bond classes and strategies for access to varied investment opportunities
- A fund which capitalises on Edmond de Rothschild Asset Management's broad expertise in bond management
- Active management of modified duration within a [-2;+8] spread
- The Fund is exposed to credit risk

PRINCIPAL INVESTMENT RISKS

The subfund is classified in category 3 (A, B and I shares) in line with the nature of securities and geographical zones in the "objectives and investment policy" section of the key investor information document (KIID).

Capital loss risk: as the subfund does not have any guarantee or protection, the capital initially invested might not be restituted in full even if subscribers hold their shares over the recommended investment horizon.

Credit risk: the main risk is issuer payment default on interest payments and/or on reimbursement of the capital. Credit risk also concerns issuer downgrades.

Subscribers are warned that the subfund's net asset value could fall should a total loss be incurred on a transaction due to counterparty default. Any private company debt held directly by the portfolio or through mutual subfunds exposes the subfund to changes in the issuing company's credit rating.

Credit risk from investing in speculative securities: the subfund may invest in government and corporate rated as non investment grade by a rating agency (i.e. rated below BBB- by Standards and Poor's or an equivalent rating from another independent agency) or considered as equivalent by our investment company. These issues are so-called speculative debt securities with a higher risk of issuer default. The subfund must be viewed as partly speculative and concerns in particular investors who are aware of the risks inherent in these securities. Consequently, investing in high yield securities (speculative securities which have a higher default risk) may entail a bigger fall in the subfund's net asset value.

Interest rate risk: exposure to bond instruments, whether debt securities or money market instruments, means the subfund is sensitive to interest rate fluctuations. Interest rate risk might entail a capital loss from yield curve movements and therefore a fall in the subfund's net asset value.

Risks from emerging market investments: the subfund may be exposed to emerging markets. In addition to stock-specific risks, there is a risk from external factors, especially on these markets. Investors should also note that operating conditions and supervisory standards on these markets may differ from those on major international stock markets. As a result, holding these securities may increase the portfolio's risk. As market falls in emerging markets may be more pronounced and faster than in developed countries, the subfund's NAV may also suffer larger and faster declines.

Risk from participation in financial contracts and counterparty risk: the use of financial contracts may mean a sharper and faster fall in the subfund's net asset value than that of the markets in which the subfund is invested. Counterparty risk stems from the subfund's use of OTC financial contracts and/or temporary acquisitions and disposals of securities. These transactions may expose the subfund to counterparty default risk and therefore a fall in the subfund's net asset value.

FUND INFORMATION

Inception date: 30/12/2004

ISIN Codes
'A' Share: LU1161527038
'B' Share: LU1161526907
'I' Share: LU1161526816

Maximum management charges
'A' and 'B' Shares: 0.80% net
'I' Share: 0.40% net

Variable management fees
15% of annual performance in excess of the benchmark

Minimum initial subscription
'A' and 'B' Shares: 1 share
'I' Share: €500,000

Front load charge
'A' Share : 1% maximum
'B' Share : 3% maximum
'I' Share : None

Redemption charges: None

Income attribution
'A' and 'I' Shares: Capitalisation
'B' Share: Distribution

Benchmark: 50% of the Barclays Capital Euro Aggregate Corporate Total Return index and 50% of the Barclays Capital Euro Aggregate Treasury Total Return index

Recommended investment horizon: > 3 years

* Shares described herein are the main euro-denominated shares. The fund also has shares in USD, GBP, CHF. Please ask you sales contact for any further information.

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