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INVEST WITH CONFIDENCE

TAKING A DEFENSIVE STANCE

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We believe that the prospect of central bank tightening measures, combined with continued political uncertainty in the US and a possible slowdown in China, mean that the overall level of systematic risk (market risk) in the global economy is very high at the moment—possibly as high as it was in 2007 before the global financial crisis. Within the Dynamic Global Bond strategy (previously called Global Unconstrained Bond*), it therefore makes sense to reduce our exposure to this type of risk and allocate more to idiosyncratic (issuer specific) opportunities where we have higher conviction.

We are convinced that our defensive stance is appropriate for the combination of risks currently facing the global economy. Volatility, which has been artificially repressed by central bank largesse, is likely to return in the near future. It is at times like these, when seeking to protect our clients against potential downside losses, that our investment approach has demonstrated its value in the past—and we believe it will continue to do so in the future.

The Dynamic Global Bond portfolio is composed of three main components: core stable positions, defensive hedges ("insurance") and return-seeking positions.

Core Positions

We are maintaining a high overall level of duration (interest-rate exposure), expressed primarily through positions in US and German sovereign debt. This reflects our view that long-term growth may disappoint, key risk triggers are numerous and there is complacency in the credit market.

Defensive Hedges

In the insurance portion of the portfolio, we have protective positions on US and European credit markets via short positions in US high yield and euro crossover indices. However, we recognize that the European credit market continues to be supported by the European Central Bank bond-buying programme and a better economic outlook, so more of our short credit positioning is expressed in the US.

We have a short position on the Russian ruble, and we are short the Mexican peso and the Australian dollar as a hedge against further commodity price corrections. We continue to believe that the Japanese yen could rally in a risk-off environment, and have implemented a long Japanese yen position.

Return-Seeking Positions

Despite our generally defensive positioning, in the return-seeking portion of the portfolio we see several attractive opportunities. For example, reforms in a number of emerging-market (EM) countries are creating the right conditions for local bond markets to thrive. By investing in local EM debt that stands to benefit from reform, growth or disinflation tailwinds, we believe we can generate attractive yield while being exposed to less systematic risk than, for example, developed market high yield bonds.

In terms of capital flows, EM debt is not currently overbought, meaning there is ample scope to invest in the asset class for investors who understand local markets. Examples include Serbian local sovereign bonds, which we think have the potential to deliver attractive returns over the next few years. The Serbian government is pursuing structural reforms and continues to make progress towards joining the European Union--factors that are bond-supportive in the long run.

** Effective June 30, 2017, the Global Unconstrained Bond Strategy was renamed the Dynamic Global Bond Strategy. This is a change in name only—the people, philosophy and management approach remain exactly the same.*

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