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Quarterly Outlook – Fixed Income

AUTHORITIES IN CRISIS MANAGEMENT MODE

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KEY INSIGHTS

- Financial markets were hit by four crises in the first quarter—public health, economic, liquidity, and energy—with uneven progress made in addressing them.
- We have been encouraged by the measures taken so far, but it's uncertain whether the 2008 crisis playbook that authorities are following will work this time around.
- We feel that it's important to be tactical in the current environment and look for opportunities identified by our fundamental research approach to take advantage of any pricing anomalies and dislocations.

In the first quarter of 2020, we quickly moved from a potential reflation scenario to a full recession environment as four separate, but related, crises hit financial markets: public health, economic, liquidity, and energy. The events were extraordinary and unlike anything seen in modern times. In response, almost all developed governments unveiled large fiscal stimulus packages, while major central banks announced significant monetary easing programmes. We have been encouraged by the measures taken so far, but it's uncertain whether the 2008 crisis playbook that authorities are following will work this time around.

UNEVEN PROGRESS IN ADDRESSING CRISES

Looking into more detail at the four issues, progress has been made in some areas but not all. With respect to liquidity, the U.S. Federal Reserve's measures have helped to improve conditions, although it may take time before markets are fully functioning again. On the energy front, the Organization of the Petroleum Exporting Countries (OPEC) reached an agreement to cut output in April, which is a promising step, but some doubts linger about whether it will be enough.

From a public health perspective, uncertainty continues, as coronavirus cases have yet to peak and countries at different stages of the outbreak. Even when the top is reached, we are still in unchartered territory as it's unlikely a vaccine will be ready for some time. On the economic front, various stimulus measures will be supportive for the recovery, but much remains uncertain. For risk markets, this could result in a volatile recovery that follows a W-shape, where a rebound is closely followed by another downturn.

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FOLLOWING A TRUSTED INVESTMENT PROCESS

Overall, we feel that it’s important to be tactical in the current environment and look for opportunities identified by our fundamental research approach to take advantage of any pricing anomalies and dislocations. We will continue to follow our trusted investment process and strive to maintain a portfolio that strikes a balance between country, duration, and yield curve positioning to take advantage of relative value opportunities globally, while also managing downside risks.

RISKS

The following risks are materially relevant to the portfolio.

ABS/MBS risk – These securities may be subject to greater liquidity, credit, default and interest ra te risk compared to other bonds. They are often exposed to extension and prepayment risk

Contingent convertible bond risk – contingent convertible bonds have similar characteristics to convertible bonds with the main exception that their conversion is subject to predetermined conditions referred to as trigger events usually set to capital ratio and which vary from one issue to the other.

China Interbank Bond Market risk – market volatility and potential lack of liquidity due to low trading volume of certain debt securities in the China Interbank Bond Market may result in prices of certain debt securities traded on such market fluctuating significantly.

Country risk (China)- All investments in China are subject to risks similar to those for other emerging markets investments. In addition, investments that are purchased or held in connection with a QFII licenceor the Stock Connect programmay be subject to additional risks.

Country risk (Russia and Ukraine)- In these countries, risks associated with custody, counterparties and market volatility are higher than in developed countries.

Credit risk- A bond or money market security could lose value if the issuer's financial health deteriorates.

Currency risk- Changes in currency exchange rates could reduce investment gains or increase investment losses.

Default risk- The issuers of certain bonds could become unable to make payments on their bonds.

Derivatives risk- Derivatives may result in losses that are significantly greater than the cost of the derivative.

Emerging markets risk- Emerging markets are less established than developed markets and therefore involve higher risks.

High yield bond risk – a bond or debt security rated below BBB- by Standard & Poor's or an equivalent rating, also termed 'below investment grade', is generally subject to higher yields but to greater risks too.

Interest rate risk- When interest rates rise, bond values generally fall. This risk is generally greater the longer the maturity of a bond investment and the higher its credit quality.

Issuer concentration risk- To the extent that a portfolio invests a large portion of its assets in securities from a relatively small number of issuers, its performance will be more strongly affected by events affecting those issuers.

Liquidity risk- Any security could become hard to value or to sell at a desired time and price.

Prepayment and extension risk- With mortgage- and asset-backed securities, or any other securities whose market prices typically reflect the assumption that the securities will be paid off before maturity, any unexpected behaviour in interest rates could impact fund performance.

Sector concentration risk- The performance of a portfolio that invests a large portion of its assets in a particular economic sector (or, for bond funds, a particular market segment), will be more strongly affected by events affecting that sector or segment of the fixed income market

General Portfolio Risks

Capital risk- The value of your investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the portfolio and the currency in which you subscribed, if different.

Counterparty risk – an entity with which the portfolio transacts may not meet its obligations to the portfolio.

Geographic concentration risk- To the extent that a portfolio invests a large portion of its assets in a particular geographic area, its performance will be more strongly affected by events within that area. **Hedging risk**- A portfolio's attempts to reduce or eliminate certain risks through hedging may not work as intended. **Investment portfolio risk**- Investing in portfolios involves certain risks an investor would not face if investing in markets directly. **Management risk**- The investment manager or its designees may at times find their obligations to a portfolio to be in conflict with their obligations to other investment portfolios they manage (although in such cases, all portfolios will be dealt with equitably). **Operational risk**- Operational failures could lead to disruptions of portfolio operations or financial losses.

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