

Kames Absolute Return Bond Constrained Fund

September 2017 review

KAMES
CAPITAL

For professional investors only

10 October 2017

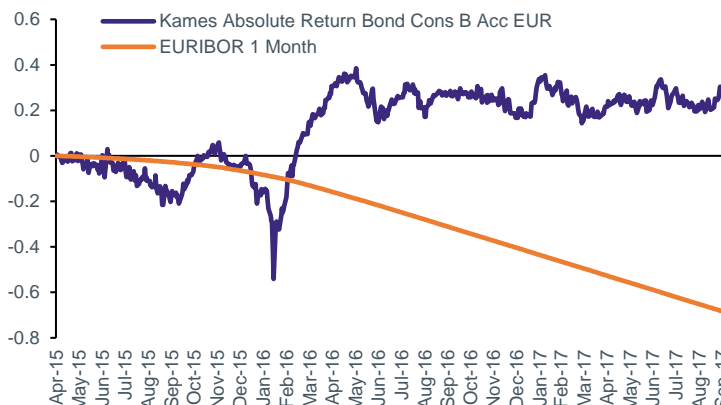


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Kames Absolute
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The Kames Absolute Return Bond Constrained Fund returned 0.07% in September, against the benchmark return of -0.03% from 1-month Euribor. The year-to-date return is 0.10%, outperforming the -0.28% return of 1-month Euribor.



Total since launch*

Fund total return	0.27%
Benchmark total return	-0.68%
Difference	0.95%
Best month	0.33%
Worst month	-0.22%
Up months	14
Down months	16
Maximum drawdown (daily)	-0.60%
Annualised volatility	0.39%
Sharpe ratio	0.92

*Source: Lipper as at 30 September 2017, net and noon prices. NAV to NAV total return with income reinvested. Local currency B (Acc) EUR class. Launch 29 April 2015. Since launch return is based on Cumulative Noon Lipper data. Benchmark is at close. Volatility and Sharpe ratio based on net annualised monthly returns since inception. Maximum Drawdown has been calculated as the largest peak-to-trough cumulative fall based on daily returns. Volatility is defined as the standard deviation of monthly returns.

Central banks have been accused over the years following on from the Great Financial Crisis (GFC) of reducing market volatility through the low/negative rates and being constantly in the market buying bonds no matter what the level of government bonds or the level credit spreads. Now we may be on verge of the Great Central Bank Unwind. The Fed are going to be reducing the balance sheet, the ECB due to buying constraints will have to amend their programme and even the Bank of England (BoE) are getting in on the act. In the September meeting the BoE made reference to reducing monetary stimulus in the coming months, then followed two very hawkish comments from Governor Mark Carney and Gertjan Vlieghe which led to a quick 30 basis points re-price across the curve. The market has not bought into the idea that the BoE will do much more than one or two hikes so if they keep the hawkish rhetoric up the market will have further to price. Headwinds are growing for the US Treasury market as well. Optimism is growing again for the tax plan, not only the simplified reform but also the tax breaks and cuts for corporate America. Whether the US economy needs this kind of stimulus at this stage of the cycle and with close to full employment is a debate for another day. The result of all of the above was that core government bond market yields moved sharply higher with yields in the US and UK moving approximately 23 basis points and 30 basis points higher respectively.

Rates

The Rates module had a decent month in September. The module benefitted from two trades involving inflation-linked bonds. The first was our long position in 10-year US TIPS versus 10-year US bond futures (long inflation breakevens). This is a longer-term trade that is looking to benefit from a re-pricing higher in US inflation expectations in the coming months. We saw signs of this beginning as headline CPI broke its run of weaker prints and the view that the impact of the storm damage in Texas and beyond is likely to be inflationary. The move higher in breakevens benefitted the Fund and we believe this has further to go. On the tactical side, we had previously bought ultra-long-dated UK index-linked gilts versus 10-year gilt futures following a period of weak price action in long linkers. We saw this move in our favour in the early part of the month, allowing us to lock in a profit.

The renewed optimism over the outlook for US growth and inflation saw US Treasuries under pressure – within the module we added short positions in 5 and 10-year US futures against longs in 3 and 10-year Australian bond futures respectively. These positions were challenged into mid-month but recovered sharply after the Fed meeting as US Treasuries faltered. We closed the 3-year Australia versus 5-year US ahead of month-end but retained the 10-year cross-market position.

Ahead of the Bank of England meeting we reviewed our long 10-year UK versus short 10-year France position – given how dovish expectations were we decided to close this to protect against any upside surprise from the MPC. Although this position was closed having detracted from performance in September, the decision to do so was proved correct as the spread moved a further 20 basis points wider. The change in tone from the Bank of England opened the door to adding a long 30-year UK versus short 10-year UK position – we expect 10-year UK gilts to underperform 30-year bonds causing

the curve to flatten in the forthcoming period. This flattening has already started, generating alpha for the Fund.

Credit

We selectively added to individual names in the month where we saw value, after the UK front end rates sold-off. This offered good opportunities to invest in some idiosyncratic names.

Carry

The Carry module is a diversified range of investment grade assets with less than two years to maturity, which we expect to hold to maturity. We currently have close to 60 holdings in the Carry module; the majority are in US and UK markets and have an average maturity of close to 12 months.

James Lynch

*Source: Lipper as at 30 September 2017, noon prices, NAV to NAV returns; local currency B (Acc) EUR share class. Index based on closing prices.

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Fund Charges are taken from income but will be taken from capital where income is insufficient to cover charges.

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Kames Capital Investment Company (Ireland) Plc operates two different methods of hedging share classes. Full details of these can be found in the prospectus.

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