

Kames Absolute Return Bond Fund

September 2017 review

KAMES
CAPITAL

For professional investors only

06 October 2017



Stephen Snowden
Co-manager of the
Kames Absolute Return
Bond Fund

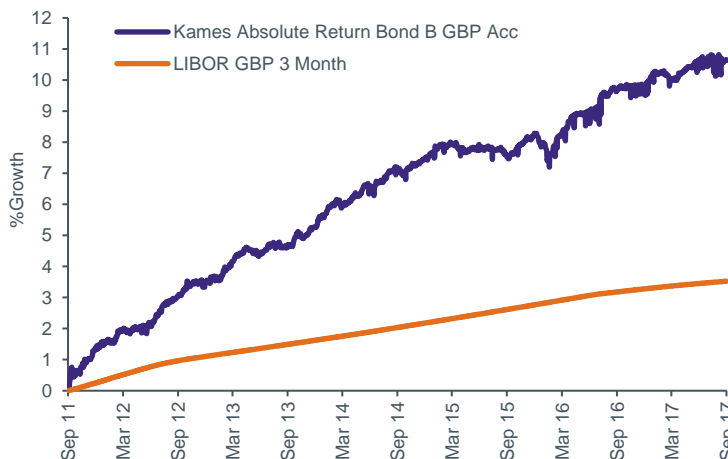


Colin Finlayson
Co-manager of the
Kames Absolute Return
Bond Fund



Nick Chatters
Support Manager of the
Kames Absolute Return
Bond Fund

The Kames Absolute Return Bond Fund returned -0.08% in September compared the benchmark return of 0.03% for 3m GBP LIBOR. The year-to-date return is now 0.74% compared to 0.24% for the benchmark.*



Total since launch

Fund total return	10.63%
Benchmark total return	3.53%
Difference	7.10%
Best month	0.60%
Worst month	-0.31%
Up months	50
Down months	22
Maximum drawdown (daily)	-1.00
Volatility (Annualised)	0.69
Sharpe ratio (Annualised)	1.64

*Source: Lipper as at 30 September 2017, net and noon prices. NAV to NAV total return with income reinvested. Local currency B (Acc) GBP class. Launch 30 September 2011. Since launch return is based on Cumulative Noon Lipper data. Benchmark is at close. Maximum Drawdown has been calculated as the largest peak-to-trough cumulative fall based on daily returns. Risk Statistics based on net annualised monthly returns. Volatility is defined as the standard deviation of monthly returns.

The summer lull feels like it may be over. September saw some volatility injected back into bond markets, led by Government bonds, as central banks returned to centre stage and a fiscal boost in the US appeared to be on the table again. The key central bank turned out to not be the ECB as many had expected – they again delayed making any announcement on policy beyond yearend – but instead was the Bank of England. At the September meeting they voted 7-2 in favour of unchanged rates but in their accompanying statements they indicated that the majority of members believe they may need to move rates higher in the coming months to bring inflation back towards target. When this message was echoed by Gertjan Vlieghe, the committee's arch-dove the following day, the market quickly moved to discount a hike as soon as November. Having appeared to be resolutely "on hold", this change in tact caught the market by surprise and in the end saw 2-year gilt yields rise by over 30 basis points over the month. The market is now priced for at least two hikes in the next year, a little more than is priced for the US Federal Reserve. The Fed themselves struck a less dovish tone at their meeting as Chairwoman Yellen presented a willingness to look through recent weak inflation prints and see positives on the growth side via the storm related rebuilding amongst other things. They also announced the start of their balance sheet reduction which was in-line with the framework they had previously announced and in turn had little impact on the market. The headwinds for US Treasuries were then intensified by growing optimism surrounding President Trump's latest tax plans that, although still a little light on precise detail, appear to have broader support within the Republican party and has a greater chance of success than his ill-fated healthcare reforms. 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.

Credit

The Credit module saw brisk activity over what was a challenging month. We took the opportunity to close an existing index level pair trade and in turn, open a new one. We had been running a long-risk US high yield versus a short-risk European high yield position (via CDX HY versus iTraxx Xover). This had sought to benefit from a more generous spread in the US market relative to that in Europe but the spread failed to compress. In September CDS contracts perform their semi-annual "roll" and our analysis indicated that it would make iTraxx Xover less attractive for a short-risk position – we therefore closed our position, taking a modest loss.

We then took the opportunity to add a long-risk iTraxx Xover versus short-risk iTraxx Main position (euro high yield versus investment grade), in part based on the analysis mentioned above. This trade was implemented in a beta-adjusted manner with 0.25 units of Xover versus 1 unit of Main. This helps remove the directionality of the position.

On the single name CDS side, we closed down a number of positions including our long-risk Shell versus short-risk Repsol, long-risk Lafarge versus short-risk Heidelberg and also the long-risk iTraxx Senior Financials versus Credit Suisse. These positions had collectively added value to both the module and the Fund.

We also took the opportunity to open some new positions including some within the European bank space. German bank bonds, particularly at the senior level, look rich compared to other similar banks across the region. To exploit this, we took short-risk positions in Commerzbank and Deutsche Bank against long-risk positions in Credit Suisse (reversing the short position mentioned above) and Mediobanca in Italy. At the same time we opened a short-risk Barclays versus long-risk iTraxx Senior Financials. Like their German counterparts, Barclay's spreads look too low relative to their fundamentals with scope for them to underperform the broader banking complex.

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 repricing 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 more 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.

Carry

The Carry module had a more difficult month than usual. The module invests in bonds with a maturity of less than two years. With the aggressive moves in this part of the curve, the module faced a clear headwind over the month. Some of this was lessened by our exposure being spread across the 0 to 2-year maturity spectrum and not concentrated solely in the 24 month area as well as by the additional yield spread that absorbed some of the move. While this was a challenging backdrop for the module, we do not anticipate similar surprise moves in the coming months, given how far expectations have moved. The result is that we can now buy bonds at more attractive yields that, as they roll down to maturity, will add value to the Fund as a whole.

Colin Finlayson

*Source: Lipper as at 30 September 2017, noon prices, NAV to NAV returns, income reinvested, net of ongoing charges, excluding entry or exit charges; local currency B (Acc) GBP share class. Index based on closing prices.

For Professional Clients only and not to be distributed to or relied upon by retail clients.

Past performance is not a guide to future performance. Outcomes, including the payment of income, are not guaranteed.

Opinions expressed represent our understanding of the current and historical positions of the market and are not an investment recommendation or advice. Any securities and related trading strategies referenced may or may not be held/used in any strategy/portfolio. Any Opinions and/or example trades/securities are only present for the purposes of promoting Kames Capital's investment management capabilities. Sources, both internal and external, used are deemed reliable by Kames Capital at the time of writing.

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

All data is sourced to Kames Capital unless otherwise stated. The document is accurate at the time of writing but is subject to change without notice. Data attributed to a third party ("3rd Party Data") is proprietary to that third party and/or other suppliers (the "Data Owner") and is used by Kames Capital under licence. 3rd Party Data: (i) may not be copied or distributed; and (ii) is not warranted to be accurate, complete or timely. None of the Data Owner, Kames Capital or any other person connected to, or from whom Kames Capital sources, 3rd Party Data is liable for any losses or liabilities arising from use of 3rd Party Data.

This document does not constitute an offer or solicitation to buy any funds mentioned, and no promotion or offer is intended in jurisdictions other than those where the fund(s) is/are authorised for distribution.

Kames Capital Investment Company (Ireland) plc (KCICI plc) is an umbrella type open-ended investment company with variable capital, registered in the Republic of Ireland (Company No. 442106) at 25-28 North Wall Quay, International Financial Services Centre, Dublin 1. Board of Directors: M Kirby and B Wright (both Ireland), A Bell (UK). KCICI plc is regulated by the Central Bank of Ireland.

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

The Kames Absolute Return Bond Fund is currently authorised for distribution in UK, Channel Islands, Ireland, Luxembourg; Switzerland, Malta, Germany, Austria, the Netherlands, Spain, Belgium, Sweden and Italy. Not all available share classes are registered in every country. Refer to the full prospectus for details.

For investors in Austria, Germany, Luxembourg, Malta, the Netherlands, Spain, Sweden and Professional/Qualified investors in Italy and Belgium – Kames Capital investment Company (Ireland) plc (the "Company") is a UCITS collective investment scheme registered with the relevant regulator in each jurisdiction. The Prospectus, Supplement, Key Investor Information (KIID) and reports for the Company together with relevant information and details of paying and information agents, as required by local regulators, are available free of charge and links to them may be found at www.kamescapital.com

For investors in Switzerland - the Company is authorised by FINMA as a Foreign Collective Investment Scheme. The articles, Prospectus, Key Investor Information and reports are available from www.kamescapital.com or from the Representative and Paying Agent in Switzerland, CACEIS (SA) Switzerland, Chemin de Precossy 7-9, CH-1260 Nyon / VD, Suisse, Phone: +41 22 360 94 00, Fax: +41 22 360 94 60