# Kames Absolute Return Bond Global Fund

August 2017 review

KAMES CAPITAL

**For professional investors only**

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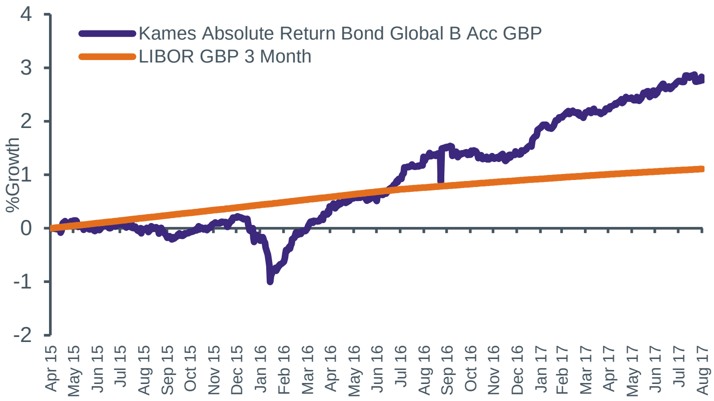
The Kames Absolute Return Bond Global Fund returned 0.01% in August, underperforming the 3-month GBP LIBOR return of 0.02%. The year-to-date return is 1.35% compared to 0.21% for 3-month GBP LIBOR.* The Fund seeks to deliver a positive absolute return in all market circumstances while preserving capital and limiting volatility.




**Total since launch***

| | |
|---|---|
| Fund total return | 2.77% |
| Benchmark total return | 1.11% |
| Difference | 1.66% |
| Best month | 0.64% |
| Worst month | -0.44% |
| Up months | 20 |
| Down months | 9 |
| Maximum drawdown (daily) | -1.22% |
| Annualised volatility | 0.83% |
| Sharpe ratio | 0.81 |

*Source: Lipper as at 31 August 2017, net and noon prices. NAV to NAV total return with income reinvested. Local currency B (Acc) GBP 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.

August proved to be a typical summer month with regards to both market activity and news flow. There is a sense that investors are opting to wait on the outcome of key upcoming events before deploying more risk. As a result, volatility was low across most areas of the market with yields and spreads generally lower over the period. Driven in part by geo-political risks emanating from North Korea and further disappointing inflation data in the US, yields across core government bond markets fell and expectations of further monetary tightening were reduced.  This move was highly correlated across our core markets of the US, Germany and UK with 10-year yields in each falling either 18 or 19 basis points. This lack of dispersion across markets highlights the challenge faced when looking for cross-market rates opportunities. Thankfully, there are a number of potential catalysts for a spike in volatility in the coming weeks with the next ECB meeting leading the way followed by the expected announcement of a reduction in the Fed balance sheet later in the month. Of these, the ECB meeting is the greater source of uncertainty – Mario Draghi may be forced to yet again walk a tightrope between acknowledging better economic data but without creating a “tantrum”. With the recent strength of the euro he may have found his “get out of jail” card that allows him to retain a dovish bias while tapering – something he is more than capable of doing. With expectations for the meeting already being pared back and yields accordingly lower, the market feels finely poised as we enter the new month.

## Credit and Asset Allocation

The Credit and Asset Allocation module fulfils two functions within the overall global strategy, namely selection and protection. The first theme allows us to exploit idiosyncrasies within the broader fixed income market. We look for trades with asymmetric payoffs, in which the downside is defined and limited while the upside is significant. The second theme looks for trades which will provide downside protection and dampen the volatility of the overall Fund. The portfolio of yield enhancing credit bonds added value and selective new issues also contributed to return. To give the Fund the diversification balance that we seek, there are a number of trades that manage the overall credit spread sensitivity of the portfolio. In this vein, we added credit protection through iTraxx Xover which is a relatively high beta part of the credit market. When credit spreads widen this protection provides a hedge which contributes to preserving capital within the strategy.

## Rates

The Rates module was also relatively flat over the period. We took profits on our Australian 3-year versus 10-year curve steepening position in the early part of the month as the sell-off in late July saw 10-year assets underperform those further down the curve.

The Australian market proved to be more volatile than most over the month with a marked move wider in its bond yields vs other core markets. On the last day of the month we positioned for a reversal of this adding a long position in 10-year Australian bond futures versus short 10-year US bond futures. The market is pricing in a similar degree of rate hikes in each market – we expect the Fed to tighten more than the Reserve Bank of Australia allowing the Australian market to outperform.

We also opened a US 5-year versus 30-year curve steepening position. With a reduction in the size of the US Federal Reserve's balance sheet expected, we see that as being more negative for long-dated bonds. Add in the fact that, while US CPI continues to disappoint, the underlying growth of the economy is robust – this has the potential to support shorter-dated assets relative to longer-dated bonds. As of month-end the curve was broadly unchanged compared to our entry point.

## Carry

The Carry module consists of investment grade bonds only with a maturity up to 5-years. These bonds are overwhelmingly viewed on a hold-to-maturity basis. While there are mark-to-market moves driven by changes in the underlying government bond yield and credit spreads, the excess spread will accrue over time and deliver the cash-plus return we seek from this module. The weighting of this module has reduced over time as the all-in-yields available have fallen. Also, the country allocations have steadily reduced the US dollar weighting as the currency hedge costs counter-balance the higher yields available in that market.

**John McNeill**

*Source: Lipper as at 31 August 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.