

# Kames Absolute Return Bond Global Fund

September 2017 review

KAMES  
CAPITAL

For professional investors only

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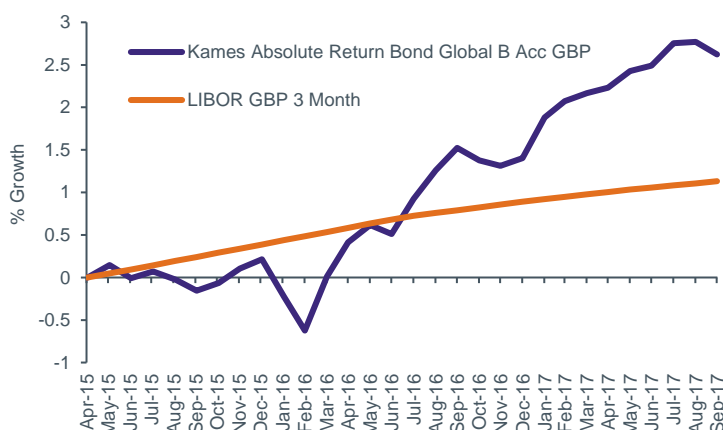


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The Kames Absolute Return Bond Global Fund returned -0.1% in September, underperforming the 3-month GBP LIBOR return of 0.03%. The year-to-date return is 1.20% compared to 0.24% for 3-month GBP LIBOR.\* The Fund seeks to deliver a positive absolute return in all market circumstances while preserving capital and limiting volatility.



## Total since launch\*

Fund total return	2.62%
Benchmark total return	1.13%
Difference	1.48%
Best month	0.64%
Worst month	-0.44%
Up months	20
Down months	10
Maximum drawdown (daily)	-1.22%
Annualised volatility	0.82%
Sharpe ratio	0.71

\*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 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.

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 not to be the ECB as many had expected – it again delayed making any announcement on policy beyond year-end – but instead was the Bank of England. At the September meeting it voted 7-2 in favour of unchanged rates but in its accompanying statements the Monetary Policy Committee 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 tack 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 itself struck a less dovish tone at its 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. The Fed also announced the start of its balance sheet reduction, which was in-line with the framework it 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 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 Credit module saw brisk activity over what was a challenging month. In September CDS contracts performed their semi-annual "roll" and gave an opportunity to re-calibrate the protective hedges within the strategy. Within this we removed the protection against wider emerging market bond spreads on the view that the cost of this insurance was too expensive relative to any prospective widening in this market segment.

We then took the opportunity to add a long-risk iTraxx Xover versus short-risk iTraxx Main position (euro high yield versus investment grade), to benefit from the relative value in high yield compared to investment grade. This trade was implemented in a beta-adjusted manner with 0.25 units of Xover versus one unit of Main. This helps remove the directionality of the position.

## Rates

The Rates module had a decent month in September. The module benefited 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, coupled with the belief that the impact of the storm damage in Texas and beyond is likely to be inflationary. The move higher in breakevens benefited 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 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 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 five years. With the aggressive moves in the short end 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 5-year maturity spectrum 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 which, as they roll down to maturity, will add value to the Fund as a whole.

**John McNeill**

\*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.

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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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