SphereInvest | GROUP

SPHEREINVEST GLOBAL CREDIT STRATEGIES (UCITS) FUND

Weekly Performance Period: 29th November to 31st December 2013

Class F (USD): MTD return: 0.67% YTD 2013 return: 6.40% NAV per Share: 113.75

Class D (EUR): MTD return: 0.65% YTD 2013 return: 6.11% NAV per Share: 113.10

Portfolio and Market Commentary:

Although the Fed finally announced the much feared "asset purchase taper" on December 18th, most risk assets performed well during the month. US, European and Emerging Market high yield credit returned 0.72%, 0.94% and 0.75%, respectively, while investment grade markets suffered from the sell-off of treasuries later in the month and returned -0.12% (1). Although the decision to taper came a few months earlier than expected by most market participants, the lack of strong reaction probably reflected a desire to "get it over with": tapering was seen as an inescapable development, while the reduction in the pace of asset purchases announced during December was, in itself, largely symbolic and did not contradict the Fed's commitment to keeping monetary policy very accommodative. Finally, December's taper decision came on a background of accelerating growth in the US: this was in contrast with the summer of 2013, when the first talks of taper were all the more troublesome that the pace of economic recovery in the US was still very uncertain, raising fears of a major policy mistake by the Fed.

In the context of a month shortened by the holiday season and in the absence of major credit specific developments, all the positions in the fund performed satisfactorily during December, with returns driven primarily by carry. We review in the following paragraph the main drivers of the performance of the fund during 2013.

The fund aims to capture return enhancing opportunities by keeping relatively concentrated exposures, with high conviction positions capped at around 4% of Net Asset Value (NAV). As such, we monitor and disclose in our investor letters the contribution of our largest holdings to both the NAV and the fund's profit & loss as an indicator of the performance of our credit and instrument selection. During 2013, the fund's top 5 positions represented on average 19% of its NAV, and contributed to c. 28% of the monthly performance. A few investments detracted meaningfully from the fund's performance, with our five worst performing positions generating in aggregate 110bps of negative return for the year. That negative performance resulted, in our view, from the timing of their implementation – shortly before the market downturn in May 2013 – rather than from deterioration in credit fundamentals during the holding period. Our investment in the Indonesian media company Bhakti Investama was our single worst performing position, generating approximately 30bps of negative performance. Although the Fund kept a predominant exposure to EM credits during 2013, most of our positions proved resilient to the volatility experienced by the asset class after May. Our sector selection partly explained that resilience: among the credits classified as "EM", the fund held a significant exposure to the oil & gas sector throughout the year, which benefited from a supportive price environment for oil. Early in the second half of 2013, the fund significantly reduced its exposure to the EM countries most vulnerable to rising yields in the US and no longer held any exposure to countries such as Turkey (last position sold on 07/08) or Indonesia (last position sold on 30/09) by the end of the third quarter. Our exposure to Brazil remained more significant through the year, but concentrated in credits with clear drivers of near term outperformance. Overall, our Brazilian positions performed satisfactorily and accounted for approximately 11% of the year's return. Finally, the fund's exposure to Euro- and Sterling-denominated credits contributed positively to the fund's performance. We built up our exposure to non US$-denominated bonds through the first half of the year, from

14% at the end of 2012 to around 26% in June (that proportion remained stable during the second half, and was 28% at the end of 2013). Although EM credit, as an asset class, dramatically underperformed Developed Markets (DM) during 2013, currency denomination proved a more important marker of performance than the EM/DM distinction for the fund. Specifically, our investments in the Euro-denominated bonds of Ciech, the Polish chemicals company, and Agrokor, the Croatian retailer, both ranked among our five best performing positions in 2013.

Similarly to 2013, the bottom-up construction of our portfolio will continue being the primary driver of our allocation between EM and DM credits, while our bias towards yield-based investment decisions is also likely to continue resulting in an overallocation to credits classified as "EM". At the same time, investors looking at DM and EM high yield start 2014 facing different challenges and interrogations, which we outline below.

Despite some tremors in Cyprus and Italy, concerns about a potential break-up of the Eurozone largely faded over 2013 as a result of better policy making and improving macro conditions. We remained reluctant to engage more fully in European HY credit through 2013, as we believed valuations were reaching unattractive levels, at least relative to their post-2009 history. The key question we now face is whether the timeframe we used inclined us towards a wrong valuation framework, given the normalization of Sovereign risk premiums (itself a bold assumption, since debt levels remain unsustainable in the European periphery). While Euro HY spreads (330bps as of the end of 2013) appear unattractive relative to their average since 2009 (644bps), it is worth remembering that they compressed to 150bps in the last stage of the previous cycle leading to 2008 – a period during which, arguably, risk-free-rates were much higher. In the absence of convincing signs that the cycle is accelerating (such as, for instance, deteriorating profitability and liquidity, or widespread non-productive releveraging deals) leading to a pick-up of default rates, we acknowledge that the path of least-resistance could well be for spreads to continue coming in. At the same time, our business remains to buy "high yield" bonds, rather than "high spread" ones, and we see no strong rationale to take a more beta-oriented exposure to the European High Yield market while earning a yield of just 4.44% (2).

In contrast to the ebullience in DM, sentiment towards EM credit deteriorated markedly during 2013. Rising yields in the US acted as catalyst for latent concerns about a large part of EM, including investors' former favourites such as Indonesia or Brazil. In hindsight, those concerns were recognized much earlier (arguably as early as 2011) by equity investors, who focus on growth, than by credit investors, who took too much comfort in the strength of EM Sovereigns fiscal positions, a more backward looking indicator. Following a period of panic during last summer, when several EM currencies saw dramatic falls against the dollar, we believe the mood towards the EM asset class has evolved towards a general weariness. Most investors recognize that the strengths which used to justify investing in Emerging Markets did not evaporate with the first talks of taper. However, several large EM countries have repeatedly failed to live up to foreign investors' expectations in recent years. The absence of a "quick fix" to lift structural capacity constraints, and significant headwinds from rising yields in the US and the shift of China towards a less capital-intensive growth model, leaves little hope for acceleration in 2014. For all of this, strong growth is neither a requisite, nor actually always desirable, for credit investors to make a good return, and EM credit offers a rarity in today's investment landscape: a class of risk assets where valuations, if not screamingly cheap, are not at all time highs or tights.

(1) Source: Bank of America Merrill Lynch indexes H0A0, HP00, EMHB and G0BC

(2) BofA Merrill Lynch European Currency High Yield Index, Yield to Worst as of 31/12/13

Portfolio Composition:

	Average Rating	Market Value (%)	Price	Mod. Dur.	Yield	Carry	Z-Spread	PnL Contrib.
SphereInvest Global Credit Strategies								
	B+	100 %	104.9	3.0	5.5 %	6.2 %	436	100 %
Largest 5 Positions								
	B	21 %	106.7	3.8	8.7 %	9.7 %	728	29 %
Regions								
Developed Europe	B+	26 %	107.6	4.4	7.4 %	8.5 %	569	28 %
LATAM	BB	19 %	104.8	4.3	6.4 %	7.2 %	462	27 %
Cash	AA	18 %						0 %
Eastern Europe / CIS	B+	17 %	103.9	3.5	8.6 %	9.4 %	735	26 %
NJA	B+	9 %	103.8	2.9	7.3 %	8.6 %	626	14 %
Treasury bills	AAA	7 %	100.0	0.2	0.0 %	0.0 %	0	0 %
North America	B+	3 %	105.6	5.0	6.4 %	7.1 %	423	4 %
Africa	B+	1 %	100.5	5.5	6.5 %	6.6 %	422	1 %
Corporates/Financials								
Corps	B+	55 %	105.1	4.3	7.0 %	7.8 %	537	75 %
Financials	BB-	20 %	106.3	3.3	8.4 %	9.6 %	696	25 %
Cash	AA	18 %						0 %
Treasury bills	AAA	7 %	100.0	0.2	0.0 %	0.0 %	0	0 %
Sectors								
Cash	AA	18 %						0 %
Oil, Gas & Consumable Fuels	BB-	17 %	104.6	4.6	7.0 %	7.7 %	505	21 %
Consumer Finance	B+	12 %	108.5	3.9	9.2 %	10.4 %	729	10 %
Media	B+	10 %	102.2	4.8	7.2 %	7.5 %	565	16 %
Commercial Banks	BB	9 %	103.4	2.6	7.3 %	8.4 %	647	15 %
Treasury bills	AAA	7 %	100.0	0.2	0.0 %	0.0 %	0	0 %
Telecommunications	B	5 %	104.4	4.6	7.9 %	8.3 %	565	3 %
IT Services	CCC+	4 %	108.7	4.5	8.0 %	9.1 %	662	4 %
Gaming	B+	4 %	109.6	3.3	7.0 %	8.9 %	602	6 %
Environmental Services	B+	3 %	106.2	4.9	7.3 %	8.0 %	578	3 %
Metals & Mining	BB+	3 %	108.0	3.3	4.4 %	6.2 %	320	2 %
Food Products	BB	3 %	105.6	3.3	6.6 %	7.8 %	534	5 %
Machinery	B+	3 %	105.0	2.2	6.2 %	8.1 %	561	4 %
Airlines	BB+	1 %	104.0	5.6	5.3 %	5.8 %	301	3 %
Communications Equipment	BB-	1 %	102.5	3.9	8.4 %	8.8 %	674	3 %
Utilities	-	0 %						5 %

	Average Rating	Market Value (%)	Price	Mod. Dur.	Yield	Carry	Z-Spread	PnL Contrib.
Ratings								
B+	B+	21 %	105.2	4.2	7.1 %	8.0 %	554	30 %
AA	AA	18 %						0 %
BB-	BB-	16 %	106.3	3.1	7.7 %	9.0 %	640	27 %
B-	B-	10 %	106.7	3.9	9.3 %	10.2 %	756	7 %
BB	BB	9 %	103.6	3.9	7.2 %	8.0 %	550	7 %
BB+	BB+	8 %	106.5	4.9	5.3 %	6.4 %	336	10 %
AAA	AAA	7 %	100.0	0.2	0.0 %	0.0 %	0	0 %
B	B	5 %	101.2	5.1	7.5 %	7.7 %	586	9 %
CCC+	CCC+	4 %	108.7	4.5	8.0 %	9.1 %	662	4 %
BBB-	BBB-	2 %	101.4	3.4	4.3 %	4.7 %	315	6 %
Currencies								
USD	BB+	72 %	103.5	2.5	4.8 %	5.4 %	385	62 %
EUR	B	18 %	105.8	4.6	7.4 %	8.2 %	600	26 %
GBP	B+	10 %	111.4	4.4	7.2 %	8.7 %	502	12 %

Performance Table since Inception:

Class F (USD)

	Jan	Feb	Mar	April	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD
2012							0.15%	0.72%	0.78%	2.11%	1.24%	1.72%	**6.90%**
2013	0.97%	0.11%	0.54%	1.64%	-0.04%	-2.16%	1.11%	-0.06%	1.70%	1.66%	0.14%	0.67%	**6.40%**

Class D (Euro)

	Jan	Feb	Mar	April	May	Jun	July	Aug	Sep	Oct	Nov	Dec	YTD
2012							0.20%	0.66%	0.70%	2.04%	1.20%	1.62%	**6.59%**
2013	0.87%	0.12%	0.54%	1.54%	-0.06%	-2.21%	1.16%	-0.07%	1.67%	1.66%	0.13%	0.65%	**6.11%**

Past Performance is no guarantee of future results.

Performance figures are net of all fees.