SphereInvest | GROUP

SPHEREINVEST GLOBAL CREDIT STRATEGIES (UCITS) FUND

Weekly Performance Period: 3rd October to 30th October 2014

Class F (USD): MTD return: 0.14% YTD 2014 return: 6.62% NAV per Share: 121.28

Class D (EUR): MTD return: 0.12% YTD 2014 return: 6.40% NAV per Share: 120.33

Annualized Return since inception: 8.5% Annualized Volatility: 2.2% Sharpe Ratio: 3.8

Portfolio and Market Commentary:

In October, Global financial markets experienced, by many measures, their most volatile period since the summer of 2011. The S&P500 declined 5.5%, almost erasing its year-to-date return, before gaining 8.4% to reach a new record high on October 31st. The VIX, a measure of equity implied volatility, briefly rose above 30% on October 15th, before falling back to end the month at 14%. The volatility in US Treasuries was as remarkable: having peaked at 2.43% during the first week, 10-year rates fell as low as 1.86% intraday on 15/10, before recovering to end the month at 2.33% – a range of 57 basis points (or 29bps on a closing basis). In Europe, Greek government bonds 10-year yields climbed as much as 270bps but largely failed to recover, ending the month near 8%, on persisting political risks. Most commodities were weak again, with the acceleration of the decline in oil prices attracting most attention: the Brent benchmark fell almost $10 during October to $86, $26 below its recent high last June.

Moves in credit markets were tamer by comparison- Investment Grade markets notably benefited from the strength in core rates to remain in positive territory throughout the month and return 0.55%. US high yield at first appeared to extend their recent underperformance and declined 1.3% before jumping 1.9% in just 4 sessions to return 0.83% for the entire month. European HY declined 1.3% during the first two weeks and only partly recovered to end the month virtually unchanged. Finally, EM HY declined 1.87% during the first half before recovering 2.21% to return 0.34% for the month.

The initial sell-off created its own narrative: the decline of oil, fears of deflation in the Eurozone, and fears about the Ebola epidemic were variously mentioned as possible triggers. However, solid corporate earnings and mixed (or even encouraging, away from the Eurozone) economic data pointed to a technical correction, in our view. The lack of fundamental driver behind the sell-off was best illustrated by the Treasury “flash-crash” on 15/10, which followed the publication of weak month-on-month retail sales, despite it being a volatile economic release of limited significance to Treasury investors. The capitulation of stretched pro-risk positions was probably amplified by dealers’ inability to provide liquidity. Interestingly, the resilience of higher-quality assets (such as IG credit, or BB rated bonds) pointed to limited forced-selling throughout this episode of market stress, indicating that market participants may have adapted to the lower liquidity environment, for instance by holding more cash than they used to before post-crisis bank regulations, such as the Volcker Rule, were implemented.

The Fed confirmed on October 29th it was concluding its QE programme, although it also kept its guidance to keep its target range unchanged “for a considerable time”. While it is usually acknowledged QE had limited success in supporting the "real economy", it is often taken for granted risk assets were supported by the Fed’s liquidity injections: we address below the concern valuations are at risk now that QE has ended. A full discussion of QE is beyond the scope of our letter. We note, however, there remains considerable uncertainty about how the programme impacted risk assets, away from naive graphs plotting the size of the Fed balance sheet against the S&P500. Common talk about the “liquidity punchbowl” provided to investors has obscured the fact that the Fed’s asset purchases were largely offset by the creation of extra reserves. Concerns rates were being kept “artificially low” have, so far, not been vindicated during 2014: to the contrary, declining nominal growth expectations in major Developed Markets have emerged as a key factor to explain the persistence of low rates in spite of the “tapering”. It is likely QE supported risk appetite primarily by giving investors the confidence the Fed was ready to use all tools at its disposal to achieve its dual mandate. Conversely, October’s volatility may reflect concerns the ECB is lacking the tools, political legitimacy or decisiveness, given its internal splits, to counter deflation threats. Financial markets recovered last month in part on hope the ECB will be forced to enlarge the pool of assets it targets for purchase to include corporate bonds and eventually Sovereign bonds: with the next meeting as soon as 06/11, we believe more indications of indecisiveness would likely reinforce the perception that "the Emperor has no clothes", with negative repercussions for European risk assets.

The Fund had a challenging first two weeks, falling 0.74% through October 16th, before adding 0.89% during the second half. As explained in our previous letter, our positioning was defensive going into October. Nonetheless, the risk of a self-feeding market correction whereby higher yields ultimately lead to higher defaults (as issuers dependent on bond markets become unable to refinance) still forced us to reassess and crystallise losses on a few short-dated positions during the first half of the month: generically, those positions, first among which the short-dated bonds of Hyva, the hydraulic cylinders manufacturer, were the main negative contributors to the Fund’s performance. Our position in Helios Towers Nigeria (“HTN”), the tower company, was the second worst performing position, on negative sentiment towards African assets due to the decline in oil prices, the Ebola epidemic, and poorer technicals, given the short track record of the issuer on international bond markets. We do not believe the key strengths of HTN, such as its stable and recurring revenues (it leases towers to large multinational telecom companies operating in Nigeria) and strong growth potential are being materially challenged by the Ebola outbreak (incidentally, Nigeria was declared Ebola-free by the World Health Organization on October 17th) nor by the decline in oil prices and continue to like their bonds, currently yielding approximately 10%. The fund’s main positive contributors were primarily European High Yield positions opened during the third week, which subsequently rebounded from oversold levels: they included Wind Telecomunicazioni, the Italian telecom operator; CMA CGM, the French container shipping company; and Thomas Cook, the British leisure travel company. Finally, our position in Arrow Global, the debt collector, which had been September’s worst performer, recovered as rating agencies took a benign view of the takeover of Capquest (Moody’s actually upgraded Arrow on 15/10, to B1) allowing the company to issue floating rate notes at the end of the performance period, becoming one of the very few European high yield issuers able to tap public debt markets during October.

Market Overview

Ticker	Index	Yield	OAS (2)	Month-to-date (1) Total Return	Month-to-date (1) Chg in OAS	Quarter-to-date (3) Total Return	Quarter-to-date (3) Chg in OAS	Year-to-date Total Return	Year-to-date Chg in OAS
G0Q0	US Treasury Index	1.5	-1	0.68%	1	1.09%	1	4.78%	0
G0BC	Global Corporate Index	2.6	119	0.55%	4	0.82%	5	6.97%	-5
GI00	Global Corporate & High Yield Index	3.2	186	0.55%	2	0.80%	4	6.54%	3
HW00	Global High Yield Index	5.9	467	0.68%	0	0.80%	3	4.90%	44
H0A0	US High Yield Index	5.9	435	0.84%	-7	1.03%	-5	4.67%	35
HP00	European Currency High Yield Index	4.6	414	-0.01%	12	0.04%	14	4.70%	53
HL00	Sterling High Yield Index	6.1	453	-0.17%	28	-0.06%	29	4.36%	84
EMIB	High Grade Emerging Markets Corporate Plus Index	3.6	208	0.96%	-2	1.05%	3	7.18%	-10
EMHB	High Yield Emerging Markets Corporate Plus Index	8.1	693	0.34%	13	0.29%	21	5.39%	59

(1) From 02/10/14 to 30/10/14
(2) Option Adjusted Spread
(3) From 30/09/14 to 30/10/14

Source: Bank of America

Portfolio Composition:

SphereInvest Global Credit Strategies	Average Rating	Market Value (%)	Price	Mod. Dur.	Yield	Carry	Z-Spread	PnL Contrib.
	BB	100 %	103.4	3.9	6.4 %	6.9 %	514	100 %
Largest 5 Positions								
	BB-	18 %	107.5	3.8	6.6 %	8.0 %	531	32 %
Regions								
Latin America	BB-	28 %	103.8	5.1	6.4 %	7.3 %	465	56 %
Developed Europe	B	25 %	103.3	4.0	7.9 %	8.4 %	680	53 %
Eastern Europe / CIS	B	15 %	104.2	4.5	7.0 %	7.6 %	599	-4 %
Cash	AA	12 %						0 %
North America	B	9 %	102.9	5.0	7.4 %	7.8 %	554	15 %
Asia ex-Japan	BB-	8 %	104.1	3.4	7.7 %	8.5 %	625	-4 %
Middle East / Africa	B	3 %	94.1	3.7	10.0 %	8.9 %	841	-16 %
Corporates/Financials								
Corps	B+	70 %	102.6	4.7	7.4 %	7.8 %	606	61 %
Financials	BB-	18 %	106.3	3.5	6.6 %	8.1 %	513	39 %
Cash	AA	12 %						0 %
Sectors								
Telecommunications	B	15 %	103.9	4.9	7.1 %	7.6 %	556	44 %
Real Estate Management & Development	BB-	13 %	103.1	4.8	7.9 %	8.5 %	665	21 %
Cash and Equivalents	AA	12 %						0 %
Consumer Finance	BB-	11 %	105.3	3.8	7.4 %	8.4 %	580	35 %
Media	B+	9 %	104.6	4.1	6.4 %	7.3 %	563	-1 %
Food Products	B+	8 %	104.5	4.8	7.6 %	8.2 %	573	15 %
Commercial Banks	BB-	7 %	107.8	3.0	5.3 %	7.6 %	404	4 %
Transportation Infrastructure	B	5 %	102.3	3.4	8.8 %	9.2 %	778	12 %
Auto Components	B	4 %	105.0	5.7	6.1 %	6.6 %	405	22 %
Communications Equipment	B	3 %	94.1	3.7	10.0 %	8.9 %	841	-16 %
IT Services	CCC+	2 %	102.5	3.8	9.3 %	9.6 %	880	-21 %
Hotels, Restaurants & Leisure	B+	2 %	102.8	4.4	7.1 %	7.5 %	662	20 %
Metals & Mining	B	2 %	98.4	3.8	6.8 %	6.6 %	649	7 %
Airlines	B-	2 %	88.1	9.7	10.0 %	9.9 %	743	-9 %
Chemicals	BBB-	2 %	104.5	5.4	4.9 %	5.5 %	296	8 %
Consumer	BB+	1 %	102.1	5.8	4.9 %	5.1 %	285	11 %
Automobiles	BB	1 %	101.7	4.8	4.3 %	4.5 %	247	6 %
Construction Materials	BB+	1 %	101.9	5.7	5.5 %	5.8 %	350	5 %
Oil, Gas & Consumable Fuels	-	0 %						-9 %
Utilities	-	0 %						-10 %
Building Products	-	0 %						-14 %
Machinery	-	0 %						-25 %
Diversified Financial Services	-	0 %						-5 %
Ratings								
B	B	23 %	102.1	4.2	8.1 %	8.3 %	666	-20 %
BB-	BB-	16 %	106.9	3.8	6.7 %	8.0 %	516	37 %
BB	BB	15 %	104.9	4.9	6.2 %	7.3 %	483	22 %
B-	B-	15 %	100.5	5.2	8.1 %	8.4 %	659	47 %
B+	B+	13 %	102.9	4.2	7.2 %	7.6 %	601	37 %
AA	AA	12 %						0 %
CCC+	CCC+	2 %	102.5	3.8	9.3 %	9.6 %	880	-24 %
BB+	BB+	2 %	102.0	5.7	5.2 %	5.4 %	313	16 %
BBB-	BBB-	2 %	104.5	5.4	4.9 %	5.5 %	296	4 %
BBB	-	0 %						-9 %
NR	-	0 %						-10 %
Ratings								
USD	BB+	66 %	103.2	3.8	5.9 %	6.4 %	445	29 %
EUR	B	22 %	102.4	4.3	7.0 %	7.4 %	653	39 %
GBP	B+	12 %	105.8	3.9	8.1 %	9.0 %	639	32 %

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%**
2014	0.84%	1.08%	0.84%	1.10%	1.20%	1.04%	-0.20%	0.91%	-0.51%	0.14%			**6.62%**

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%**
2014	0.85%	1.06%	0.77%	1.09%	1.25%	1.01%	-0.21%	0.92%	-0.62%	0.12%			**6.40%**

Past Performance is no guarantee of future results.
Performance figures are net of all fees.

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