SphereInvest | GROUP

SPHEREINVEST GLOBAL CREDIT STRATEGIES (UCITS) FUND

Weekly Performance Period: 30th August to 3rd October 2013

Class F (USD): MTD return: 1.70% YTD 2013 return: 3.82% NAV per Share: 110.99

Class D (EUR): MTD return: 1.67% YTD 2013 return: 3.56% NAV per Share: 110.39

Portfolio and Market Commentary:

July's and August's disappointing non-farm payrolls, as well as the withdrawal of Lawrence Summers from consideration for the Fed Chair, created a strong consensus among investors that the Fed would only announce a limited and gradual reduction of asset purchases at its September meeting. The Fed's decision to leave its asset purchase programme unchanged came as a surprise to us and, we believe, most investors. It is however debatable how much the performance of markets would have differed if the Fed had gone for "taper lite" rather than no taper at all. Indeed, across many markets, much of September's gains were concentrated in the two weeks leading to the FOMC meeting, while the period following the FOMC proved much more volatile, in part due to the political situation in Italy and the US, but also, in our view, because investors were in effect already positioned for a "token-only" normalization of monetary policy, while the Fed's no-taper decision signalled that it was more worried about the strength of the US recovery (and possibly, the upcoming budget dispute) than investors had realized. Overall, September was still a very solid month for credit markets' performance: global investment grade markets returned 0.94%, although spreads were essentially flat for the month, while in high yield markets, European, US, and Emerging Markets returned 1.60%, 1.41%, and 1.72%, respectively (1).

At the time of writing our letter, markets are still gripped by the current deadlock over the budget and debt ceiling in Wasthington. We will briefly address here the possible impact of the situation on our Fund. In our view, a default by the US treasury is unhedgeable, at least for those investors unable to hold real assets directly. Given the current structure of financial markets, the assumption that the US Treasury default risk remains null is the only one under which a portfolio of financial assets can be managed. Under such a working assumption, the outcome to the deadlock is "known" already - the US Treasury will not default - and only the path leading to that outcome actually matters: how much volatility will the crisis generate, and how will this impact the fragile global economic recovery. On the first point, we believe investors have been conditioned over recent years to expect politicians, both in the US and in Europe, to step back from the brink at the 11th hour. We also believe that positioning, at least in credit markets, has remained defensive following last Summer's taper talks, and a sell-off is therefore likely to be considered a "buy-on-dip" opportunity. This, in itself, should limit volatility, although we admit anxiety is bound to rise as we approach the 17th of October. The drag on the US economy from the current government shutdown is a real concern. However, catch-up effects once the Government re-

opens fully, the probable further delay of the Fed tapering, and the recovery in other parts of the Developed World (Japan, the UK, and even Europe) means the impact of the political crisis in Washington on the economy and financial markets is impossible to assess at this point. Noting that our Fund remains very defensively positioned, with almost 25% held in cash & equivalents or in bonds which have already been called (although are still accruing interest), we feel the political crisis in Washington does not call for any adjustment at this point. The situation remains, obviously, fast changing, and we will continue to assess downside and upside risks for the fund as it evolves.

In Emerging Markets, September proved a surprisingly calm period, following three months of high anxiety culminating in the volatility experienced by EMFX during August. The previous poor performance of EM assets was fundamentally driven by a reassessment of inter-market relative value, in a world were Developed Markets appear to be recovering, while Emerging Markets are facing domestic and external challenges, after several years of policy complacency. It would be frivolous to assume that the delay of the Fed taper has fundamentally altered that picture. However, we recognize that “taper talks” were a catalyst accelerating the deterioration of sentiment towards Emerging Markets, while at the same time raising urgent challenges for the few EM countries reliant on capital inflows to finance their current accounts. A stabilization of sentiment, in other words, could in itself have led to some stabilization of fundamentals, although investors are now likely to require signs of structural reforms for such a virtuous circle to sustain itself. For the sake of the anecdote, we feel that just as much as the Economist newspaper almost perfectly timed the top of the Bovespa with their famous but overly optimistic “Brazil takes off” cover article in November 2009, their September 2013 cover (“Has Brazil blown it?”) may also come to mark the nadir of sentiment towards EM. At the micro level, we never felt that EM corporate bonds had reached oversold levels. By way of illustration, EM high yield spreads were a mere 1 basis point above their 4-year average of 740bps at the start of September, and are currently at 722bps. Given the new uncertainties raised by the current political crisis in the US, we feel that the market upside provided by the FOMC surprise decision and confirmed signs of macro stability in China has largely been exhausted at this point, and we remain comfortable with our strategy of limiting duration and focusing on idiosyncratic credit stories, as outlined in our previous investor letter.

A few positions held by the fund recorded marginally negative total returns during September, either because they were sold towards the beginning of the month, generating some transaction costs for the fund without corresponding carry, or because they experienced some capital depreciation, without specific fundamental driver. Our holding in TV Azteca, the second largest TV broadcaster in Mexico, generated 10 basis points of negative performance for the fund, and was the single largest negative contributor. In a surprising move, the company chose to issue for $500MM of 7-year US$ notes to refinance long-dated debt, in spite of their strong cash position (more than $500MM as of June 2013) and low leverage (less than 1x on a net basis). The new bonds were priced 80bps above the spread level of the notes held by the fund, causing a sharp repricing. Banco BMG, the Brazilian payroll lender, and Hyva, the container lifting systems manufacturer, were again among the strongest contributors to the performance of the fund during September (leading us to take profit in Hyva). Our holdings in QGOG Constellation, the Brazilian drilling rigs operator, performed well following the completion of an US$300MM equity contribution by its existing shareholders. Finally, a few recent, attractively priced issues

also counted among the strongest contributors for the fund. Those included our investment in Offshore Drilling Holdings' newly issued notes, secured by two new semi-submersible drill ships, and in the Euro-denominated first lien notes due 2020 of FTE Automotive, a German auto parts manufacturer which reported in-line first half of 2013 results at the end of September.

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

Portfolio Composition:

	Average Rating	Market Value (%)	Price	Mod. Dur.	Yield	Carry	Z-Spread	PnL Contrib.
SphereInvest Global Credit Strategies								
	BB-	100 %	103.4	3.5	6.8 %	7.3 %	559	100 %
Largest 5 Positions								
	B+	21 %	107.6	4.4	7.1 %	8.0 %	568	34 %
Regions								
Latin America	BB-	30 %	99.2	3.9	8.4 %	8.2 %	698	20 %
Developed Europe	B+	25 %	106.7	4.3	7.7 %	8.8 %	619	37 %
Eastern Europe / CIS	B+	17 %	107.0	5.2	7.9 %	8.9 %	624	11 %
Cash	AA	11 %						0 %
Asia ex-Japan	B+	9 %	104.5	2.0	8.3 %	10.1 %	778	26 %
Treasury Bills	AAA	5 %	100.0	0.1	0.1 %	0.0 %	0	0 %
North America	B+	3 %	100.0	5.2	7.5 %	7.5 %	552	5 %
Middle East	-	0 %						1 %
Corporates/Financials								
Corps	B+	58 %	103.0	3.8	8.4 %	9.0 %	714	80 %
Financials	BB	26 %	104.9	4.7	7.2 %	8.2 %	548	20 %
Cash	AA	11 %						0 %
Treasury Bills	AAA	5 %	100.0	0.1	0.1 %	0.0 %	0	0 %
Sectors								
Commercial Banks	BB	16 %	101.2	5.3	6.9 %	7.2 %	509	14 %
Oil, Gas & Consumable Fuels	BB-	13 %	100.8	4.3	7.7 %	8.0 %	617	15 %
Cash	AA	11 %						0 %
Media	B+	10 %	105.3	2.8	8.4 %	10.0 %	753	3 %
Consumer Finance	B+	9 %	111.6	3.8	7.7 %	10.0 %	619	5 %
Food Products	B	6 %	89.5	3.8	14.1 %	11.6 %	1283	-2 %
Treasury Bills	AAA	5 %	100.0	0.1	0.1 %	0.0 %	0	0 %
Auto Components	B	5 %	107.6	5.0	7.5 %	8.4 %	602	18 %
Telecommunications	B+	5 %	102.8	4.8	8.1 %	8.4 %	621	4 %
Chemicals	B	4 %	110.7	4.5	7.3 %	8.6 %	587	3 %
IT Services	CCC+	4 %	106.1	4.5	8.6 %	9.3 %	715	4 %
Hotels, Restaurants & Leisure	B	3 %	103.2	3.4	7.0 %	7.6 %	584	3 %
Building Products	B+	3 %	106.1	2.7	7.3 %	9.0 %	650	1 %
Gaming	B+	3 %	106.0	3.5	8.1 %	9.2 %	701	4 %
Machinery	B+	3 %	102.8	2.3	7.3 %	8.3 %	666	14 %
Real Estate Management & Development	-	0 %						6 %

© SphereInvest GROUP 2013 | Suite 41B, Regent House, Bisazza Street, Sliema, SLM 1641, Malta | TEL +356 2258 1610 | www.sphereinvestgroup.com

	Average Rating	Market Value (%)	Price	Mod. Dur.	Yield	Carry	Z-Spread	PnL Contrib.
Sectors (cont'd)								
Utilities	-	0 %						7 %
Air Freight & Logistics	-	0 %						-2 %
Consumer	-	0 %						3 %
Ratings								
B+	B+	20 %	104.8	3.2	8.0 %	9.3 %	697	26 %
B	B	19 %	101.7	4.2	9.3 %	9.2 %	795	34 %
AA	AA	11 %						0 %
BB-	BB-	10 %	107.3	3.5	7.6 %	8.8 %	627	-6 %
BB	BB	8 %	99.8	4.6	7.6 %	7.8 %	591	19 %
BB	BB+	8 %	102.8	4.8	6.3 %	7.5 %	457	6 %
B-	B-	7 %	107.1	4.2	9.4 %	10.4 %	772	10 %
AAA	AAA	5 %	100.0	0.1	0.1 %	0.0 %	0	0 %
NR	-	4 %	101.0	7.6	8.0 %	8.1 %	572	2 %
BBB-	BBB-	4 %	100.5	3.6	4.6 %	4.7 %	349	1 %
CCC+	CCC+	4 %	106.1	4.5	8.6 %	9.3 %	715	4 %
BBB	-	0 %						4 %
Currencies								
USD	BB	68 %	100.7	3.1	6.4 %	6.6 %	530	51 %
EUR	B	23 %	108.0	4.1	7.6 %	9.0 %	635	42 %
GBP	B+	9 %	109.5	4.5	7.5 %	8.7 %	566	7 %

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%				**3.82%**

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%				**3.56%**

Past Performance is no guarantee of future results.

Disclaimer:

Important Information: Issued by SphereInvest Group Limited ("SphereInvest"), which is authorized and regulated by the Malta Financial Services Authority. This publication constitutes an investment advertisement and is only being provided for illustrative purposes. It should not be construed as investment advice or an offer, invitation or recommendation to transact in any of the investment instruments mentioned in it. Potential investors should seek their own independent financial advice. Every investment involves risk, especially with regard to fluctuations in value and return. If the currency of a financial product is different from your reference currency, the return can increase or decrease as a result of currency fluctuations. The value of investments and the income therefrom can go down as well as up. Past performance is not a guide to future returns. Performance figures are shown net of all fees and expenses. The information in this publication has been compiled from sources believed to be reliable, however, no warranty, expressed or implied, is given as to its accuracy or completeness. Furthermore, neither SphereInvest nor its directors, officers or employees will be responsible for any loss or damage that any person may incur resulting from the use of this information.