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Amity Sterling Bond Fund – Q4 2019 Commentary

Quarter to end December 2019

Performance

	3 months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B class)	1.58%	3.20%	8.77%	15.61%	22.69%	75.63%
iBoxx Sterling Non-Gilts TR GBP	-0.69%	2.95%	7.83%	10.43%	22.26%	70.14%
IA £ Strategic Bond	0.90%	2.88%	9.23%	12.11%	19.63%	65.33%
Sector Quartile	1	1	2	1	2	2

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested

Yields

	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19
Distribution	4.07%	4.07%	4.09%	4.06%	4.05%	3.96%
Underlying	4.07%	4.07%	4.09%	4.06%	4.05%	3.96%

Review

Gilt yields rose considerably over last quarter of the year, as the prospects of a disorderly Brexit reduced in unison with rising optimism on global trade. A new withdrawal agreement with the European Union (EU) was reached, although prospects for parliamentary approval of the UK government's EU withdrawal bill only improved when the Conservative Party secured a large majority in December's general election. Elsewhere, falling geo-political tensions saw an unwinding of safe-haven demand for government debt. The 10-year gilt yield fell from 0.49% to a low of 0.42% before rising to a high of 0.87% in December and ending at 0.82%.

The US Federal Reserve cut its main interest rate by 0.25% in October, the third such policy action in 2019. With further stimulus conditioned on a 'material reassessment' of the US economy, the chances of further near-term rate reductions appeared to decline. The European Central Bank (ECB) resumed its corporate bond purchase programme, with inflation remaining subdued. As the period drew to a close, the US and China agreed on a preliminary deal to halt additional tariffs, engage in further negotiations and roll back selected existing tariffs.

Credit spreads tightened over the quarter as investors continued to search for income in a low-yield environment. This particularly benefitted the lower-rated credit quality segments of the market, where spreads narrowed more considerably. The declining risk premiums also helped offset the adverse impact of duration as underlying gilt yields rose.

Performance & Activity

The Amity Sterling Bond Fund's total return outperformed both its iBoxx Sterling Non-Gilts benchmark as well as the IA Strategic Bond Sector peer group over the period under review. The fund's outperformance was principally down to its positive stock selection, most notably within financials, as credit spreads on lower-rated credits tightened more relative to higher quality debt.

The fund also benefitted from its relatively shorter duration positioning compared to its benchmark as underlying gilt yields rose over the quarter. The ongoing search for income continued to boost the performance of its niche holdings in preference shares, which registered strong price gains over the last three months.

Strong cash inflows over the quarter were deployed by establishing new positions as well as adding to existing holdings. The fund established positons in the newly-issued Scottish Hydro Electric 2.25% 2035 green bond, Legal & General 3.75% 2049 (2029 call) and National Express Group 2.375% 2028, Vodafone 4.875% 2078 (2025 call), Koninklijke 5.75% 2029, SNCF Reseau 5.5% 2021, Phoenix 5.75% perp (2028 call), International Bank of Reconstruction & Development 1.25% 2023 and European Investment Bank 0.75% 2023. The fund also added to existing holdings in Reassure 5.867% 2029, Direct Line 4.75% Perp (2027 call), Co-Operative Group 11% 2025, Northern Electric plc 8.061% preference shares and Bazalgette Finance 2.375% 2027 green bond.

Outlook

With an ease to some of the global anxieties that have impinged on the prospects for growth, such as the US-China trade dispute and the UK's withdrawal from the European Union, there comes some much-needed certainty and a potential boost to consumer confidence. Whilst major central banks remain ready to support faltering economies with loose monetary policy, the limits of this strategy are becoming increasingly apparent, not least in the scarcity of high quality assets and associated adverse impacts on the operation of short-term funding markets. Consequently, there is a concerted effort to highlight the effectiveness of adopting favourable fiscal policy. For instance, the re-elected UK government is revisiting fiscal rules to allow for more infrastructure investment.

With an upcoming presidential election later this year, the likelihood of further US fiscal stimulus is also higher. For now, monetary policy may play a less pronounced role absent a material economic shock. Whereas this could support a lower for longer interest rate outlook, the potential for a market correction akin to that witnessed in late 2019 remains elevated.

For the UK, progress on trade talks with the European Union warrants close monitoring given that the probability of a disorderly departure from the EU is not negligible. Despite the ongoing search for yield, our view remains that the market's late-cycle characteristics warrant caution on credit. We would therefore maintain a focus on higher credit quality, biasing the portfolio towards shorter duration, with a large weighting towards short-dated gilts and supra-nationals enhancing portfolio liquidity and availing flexibility to seize opportunities to pick up good quality credits at valuations that we deem attractive.

Yields

The Distribution Yield reflects the amounts that may be expected to be distributed over the next 12 months as a percentage of the mid-market share price of the fund as at the date shown. The Underlying Yield reflects the annualised income net of expenses of the fund (calculated in accordance with relevant accounting standards) as a percentage of the midmarket share price of the fund as at the date shown. Both Yields are based on a snapshot of the portfolio on that day. The yields do not include any preliminary charge and investors may be subject to tax on distributions. The Distribution Yield is higher than the Underlying Yield because the fund's expenses are charged to capital. This has the effect of increasing the distributions for the year and constraining the fund's capital performance to an equivalent extent.

Further Information

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