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# Amity Sterling Bond Fund – Q3 2019 Commentary

Quarter to end September 2019

**Performance**

| | 3 months | 6 Months | 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|---|---|
| Fund Performance (B class) | 1.59% | 3.95% | 6.09% | 12.11% | 22.75% | 75.47% |
| iBoxx Sterling Non-Gilts TR GBP | 3.66% | 5.02% | 10.66% | 7.37% | 30.87% | 67.83% |
| IA £ Strategic Bond | 1.90% | 4.39% | 6.79% | 9.98% | 20.26% | 67.40% |
| Sector Quartile | 3 | 3 | 3 | 2 | 2 | 2 |

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

**Yields**

| | Apr-19 | May-19 | Jun-19 |
|---|---|---|---|
| Distribution | 4.11% | 4.01% | 4.06% |
| Underlying | 4.11% | 4.01% | 4.06% |

## Review

Gilt yields fell significantly last quarter as weak economic data and ongoing geo-political tensions weighed on market sentiment. As the UK government increased its preparations for a disorderly European Union (EU) departure, yields declined. The Bank of England voted unanimously to hold the base rate at 0.75%, but signalled willingness to cushion the impact of a weakening economy, were a no-deal Brexit to occur. The ensuing uncertainty and inventory de-stocking has since seen the UK economy slow. The 10-year gilt yield rose from 0.83% to a high of 0.84%, before falling to a low of 0.41% in September and ending the period at 0.48%.

The US Federal Reserve cut its main interest rate by 0.25% in July, with a further reduction enacted in September on the back of a weakening economic outlook. The inversion of the US yield curve, typically interpreted as a signal of a recession ahead, raised fears of a global slowdown. A US-China trade war truce continued to prove elusive. In Europe, a weaker economic environment, along with subdued inflation, led the European Central Bank (ECB) to cut its deposit facility interest rate by 0.1% and announce further bond purchases.

Credit spreads widened marginally over the last three months as heightened political uncertainty and poor economic prospects inspired a flight to quality. This benefitted safe-haven assets such as gilts. With little change to risk premiums seen, duration was the main driver of performance with longer-dated gilts leading government debt to outperform corporate bonds as yields fell considerably.

## Performance & Activity

The total return on the Amity Sterling Bond Fund lagged behind that of its iBoxx Sterling Non-Gilts benchmark as well as that of the IA Strategic Bond Sector over the period under review. The fund's performance was principally a result of its shorter relative duration, particularly as longer-maturity corporate bonds rallied on the back of declining government bond yields.

Despite an adverse duration impact, the fund saw positive contributions to performance from credit selection in the financial sector as market participants continued to search for income. It also gained from its niche exposures such as holdings in preference shares whose prices rose over the period under review.

Strong cash inflows over the quarter were used to establish new positions and to add to existing holdings. The fund initiated new holdings in KFW 5.5% 2021, AXA 5.53% perp (2026 call), Leeds Building Society 3.75% 2029, Society of Lloyds 4.75% 2024, Tesco Personal Finance 3.5% 2025, Royal London 6.125% 2028, Reassure Group 5.867% 2029 and Vodafone 3% 2056. The Fund also added to existing holdings in National Grid Finance 5.625% 2073 (2025 call), Scottish Widows 7% 2043, SSE 3.625% 2077 (2022 call), A2 Dominion 3.5% 2028 as well as the Hightown 4.4% 2025 and Golden Lane Housing 3.9% 2027 charity bonds, whilst selling out of Centrica 5.25% 2075 (2025 call).

## Outlook

With no resolution to the ongoing geo-political risks in sight, the challenging global trade backdrop across various regions has begun to crystallise into softer industrial and manufacturing production. Consequently, an outlook of

declining global growth has seen the major central banks, led by the US Federal Reserve, move to loosen their monetary policy via interest rate cuts whilst setting out a strong case for the implementation of fiscal policy support. With the UK's withdrawal from the EU yet to be agreed, the Bank of England has so far kept its policy settings unchanged, despite warning of potential shocks from a 'no-deal' EU departure and reiterating its pledge to bolster the economy in the event of a slowdown. The European Central Bank's stimulus package consisting of a deposit facility rate cut, increased long-term bank funding in addition to a resumption of asset purchases, was larger than expected and could also continue to exert downward pressure on yields, which have since revisited historic lows. A successful conclusion to the US-China trade dispute, ahead of next year's US presidential elections could see yields rise however, as would an agreement for the UK to leave the EU in an orderly manner. Our view remains that the market's late-cycle characteristics warrant caution on credit and highlight increased potential for a market correction. We would therefore maintain a focus on higher credit quality, biasing the portfolio towards shorter duration, with a large weighting towards short-dated gilts 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

To obtain further information please speak to your normal EdenTree representative, visit www.edentreeim.com or call our support team on 0800 011 3821.

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