# Stratton Street UCITS - Renminbi Bond Fund UI

## July 2015

- **Economic softness in China and the commodity crunch took focus in July**
- **Portfolio's holdings in Russia outperformed**
- **Data dependent Fed appears more hawkish; September lift-off on the cards**
- **China devalues renminbi, in pursuit for SDR inclusion, allowing market forces to play a greater role**

## Market Comment

Credit markets moved with no real direction in July, broadly all market excitement was reserved for commodities and the Chinese equity market. Having spiked ahead of the disappointing retail sales announcement Treasury yields surprisingly rallied towards the end of the month despite increasing Fed liftoff rhetoric. The benchmark ten-year fell 17 basis points to 2.18%, while the thirty-year closed below 3%; 22 basis points lower on the month. Oil prices plummeted on news that the Middle East have left the taps running, pumping out above quota record levels thus adding to the supply glut; Brent fell ~18% on the month, while West Texas Intermediate (WTI) fell below $50 witnessing its worst monthly drop since 2008 having plunged ~21%. The Gold future also suffered its longest downward streak since 1996; the potential US rate hike later this year played a part in these moves.

China was a hot topic last month as the equity market raised some concerns and manufacturing data releases were softer than expected, adding downward pressure on commodities. The Q2 GDP reading was released at 7% year-on-year, above expectations for 6.8% yoy growth and data prints for June were also supportive as retail sales, industrial production and fixed asset investment all beat market consensus. The official manufacturing PMI for July remained in expansionary territory but the Caixin manufacturing PMI missed expectations as demand both domestically and abroad was softer. Having been provided with a road map by the International Monetary Fund (IMF) Chinese authorities continued to take required steps to further internationalise the renminbi to achieve reserve currency status. The onshore and offshore renminbi were some of the best performing currencies against the strong dollar.

Elsewhere, although US data is showing signs of strengthening, data readings in June were once again mixed. US retail sales unexpectedly dropped month-on month in June versus expectations for a marginal increase; readings for April and May were also revised down. The ex auto reading also missed expectations, as did a key component for GDP estimates, the retail sales control group. The Philadelphia Fed reading fell way below expectations and the preliminary Michigan sentiment Index reading also declined. Housing data has however rebounded above expectations, and inflation ticked up slightly, though still remains a concern.

There was little in the way of Fed fund guidance, the Fed did state that labour market activity has been "solid", however members are still looking for "some further" gains. The Fed have not taken a September rate hike off the table, however the FOMC statement did comment that "economic conditions may, for some time, warrant keeping target federal funds rate below levels the committee views as normal in the longer run". Despite US GDP recovering in the second quarter we believe that growth is still somewhat lackluster. The advanced GDP annualised reading missed expectations for 2.5% quarter on quarter growth; expanding at 2.3%. Consumer spending was the main driver of growth in the second quarter as households have benefitted from lower energy prices.

## Historical Performance[1]

| | 2015 % | * Inception % |
|---|---|---|
| IDUSD Class | 6.48 | 9.24 |
| IDGBP Class | 6.52 | 10.57 |
| IDEUR Class | 6.68 | 12.47 |
| IDCNH Class | 6.38 | 12.04 |
| ODGBP Class | 5.15 | 7.14 |

## Performance Summary[1]

| Index | Monthly Return % |
|---|---|
| Renminbi Bond Fund UI (Inst USD Class) | 0.69 |
| HSBC China Offshore Renminbi bond index (USD) | -0.34 |
| Offshore Chinese Renminbi (CNH) | -0.26 |

## Fund Prices[1]

| Institutional Class | Price | Monthly Return % |
|---|---|---|
| USD | 105.22 | 0.69 |
| GBP | 104.64 | 0.71 |
| EUR | 106.34 | 0.69 |
| CNH | 107.99 | 0.81 |
| **Ordinary Class** | **Price** | **Monthly Return %** |
| GBP | 106.56 | 0.76 |

## Portfolio Statistics

| | |
|---|---|
| Gross Redemption Yield | 4.88% |
| Gross Running Yield | 5.10% |
| Fund NAV (USD Millions) | 36.20 |
| Number of holdings | 42 |
| Number of countries | 9 |
| Duration | 7.93 |

## Fund Breakdown

| Net Foreign Assets | | Credit Rating | |
|---|---|---|---|
| Rating | % NAV | Rating | % NAV |
| 7 Star | 52.38 | Aa | 40.15 |
| 6 Star | 24.37 | A | 32.14 |
| 4 Star | 19.68 | Baa | 25.96 |
| 3 Star | 3.49 | Ba [2] | 1.67 |
| Total | 99.92 | Total | 99.92 |

| Entity Type | | Region | |
|---|---|---|---|
| Entity | % NAV | Region | % NAV |
| Sovereign | 8.88 | Asia Pacific | 38.02 |
| Quasi | 63.95 | C&W Asia | 19.68 |
| Corporate | 23.60 | Middle East | 42.22 |
| Supra | 3.49 | | |
| Total | 99.92 | Total | 99.92 |

| Portfolio Exposure by Country | % NAV |
|---|---|
| Abu Dhabi | 9.62 |
| China | 23.55 |
| Hong Kong | 12.22 |
| Kazakhstan | 3.49 |
| Malaysia | 0.82 |
| Qatar | 24.76 |
| Russia | 19.68 |
| Saudi Arabia | 4.36 |
| Singapore | 1.42 |
| Total | 99.92 |

# Stratton Street UCITS - Renminbi Bond Fund UI

## Portfolio Review

The Fund's USD I Class gained 0.69% over the month while the HSBC Offshore Renminbi Bond Index was down -0.34%. Although bond markets experienced some volatility through the month our holdings held up well.

The portfolio's quasi-sovereign holdings in Russia outperformed; Vnesheconombank (VEB Capital) 5.942% 2023 was the best performer over the month having tightened roughly 12 basis points to yield 7.73%. At these levels the bond continues to offer attractive risk-adjusted returns; circa 22% with a comfortable 3.8 credit notch cushion and the added protection of government support, as the issuer is wholly owned by the Russian government. The 6.125% 2023 issue from Sberbank, which is of high systemic importance to the government, gained around two points in July and closed the month trading at a spread of 470 basis points over Treasuries. We calculate that bonds with similar ratings and duration were trading closer to 240 basis points; providing us with sufficient risk-adjusted expected returns. Russia as a creditor nation (as defined by Net Foreign Assets as a percentage of GDP) has the ability to withstand lower oil prices by allowing the rouble to depreciate, this protects many companies as they receive revenue receipts in USD with many of the operational costs in rouble. The country also has significant assets and reserves to support the credits that we own; i.e. strategically important SOE's.

Holdings in the Middle East, which have so far been some of the best performing bonds this year were pretty unchanged in July. In relation to oil specifically, we see the correlation of credit spreads and the Middle East to be very low, the countries and companies which we invest in have a large asset base and can withstand lower oil prices for a considerable period of time.

## Outlook

Elsewhere, shocked markets interpreted China's devaluation of the renminbi's fixing rate as being aimed at gaining export competitiveness; we believe that the central bank's motivation was more to do with the potential inclusion of the renminbi in the IMF's SDR basket. One of the criticisms of China's foreign exchange policy is that the exchange rate is not driven by market forces. Until recently, the central bank has set the fixing each day around which the renminbi can float in a band of +/-2%; now the fixing will be based on market pricing. To facilitate this change the PBoC needed to move the fixing to the (lower) market rate. This move created market uncertainty with some reports suggesting that China was starting a period of competitive devaluations in a bid to boost exports. In a press conference on August 13, the Chinese central bank deputy governor called such reports "total nonsense" and "completely groundless". He added that the PBoC is able to maintain currency stability, a rigid renminbi exchange rate is neither sustainable, nor suitable for China and that he expects the currency to appreciate in the future.

The short run weakness in the renminbi provides an excellent entry level for investors who are underweight the currency in our opinion. The renminbi is already the fifth most actively traded currency in the world and should become a major reserve currency at some point over the next few years, aided by its potential inclusion in the IMF's SDR basket. Investors are significantly underweight Chinese assets owing to the lack of inclusion in many major indices currently. With Chinese interest rates roughly 2-3% higher than those in the US, a stable renminbi equates to gains in US dollar terms from holding renminbi.

From a bond perspective we expect our holdings to perform well given our preference for quality. We remain comfortable with our portfolio positioning in China; the portfolio's holdings are USD denominated, predominantly in quasi-sovereign exposures backed by China's Aa3 rating.

Elsewhere, with the recent events in China and the anaemic state of the global economy, focus will shift to the Fed funds rate outlook. Our central view is that the Fed needs to get off of zero rates at least by one but probably two 25 basis point moves to defend home grown criticism before sitting back and awaiting further economic evidence regarding the global economy. Come the Fed meeting in September, the latest PBoC move will have been digested by the market and as long as there are no further surprises, will have little impact on Fed thinking. Provided a central bank is ahead of the curve, yield curves typically flatten as inflationary expectations decline. In the last three tightening cycles the short end of the bond market has delivered losses to investors, however, the long end has tended to perform much better. We expect any move by the Fed to start to raise rates will be well 'ahead of the curve' and the yield curve should remain quite flat, favouring positioning at the long end.

## Share class information

| Institutional | Current AMC | Minimum Subscription | Subsequent Investment | Front-end load | SEDOL | ISIN | Bloomberg |
|---|---|---|---|---|---|---|---|
| ID EUR | 1% | EUR 100,000 | EUR 10,000 | None | 5078151 | LU0850781518 | STRBIDE LX |
| ID USD | 1% | USD 100,000 | USD 10,000 | None | 5078175 | LU0850781781 | STRBIDU LX |
| ID CNH | 1% | USD 100,000 | USD 10,000 | None | 5078186 | LU0850781864 | STIDCNH LX |
| ID GBP | 1% | GBP 100,000 | GBP 10,000 | None | 5078208 | LU0850782086 | STRBIDG LX |
| ID GBP ACC | 1% | GBP 100,000 | GBP 10,000 | None | BVJDP45 | LU1163072603 | TBC |
| ID CHF | 1% | CHF 100,000 | CHF 10,000 | None | 5078216 | LU0850782169 | TBC |

| Ordinary | Current AMC | Minimum Subscription | Subsequent Investment | Front-end load | SEDOL | ISIN | Bloomberg |
|---|---|---|---|---|---|---|---|
| OD GBP | 1.5% | No minimum | No minimum | Up to 3% | 5078275 | LU0850782755 | STRODGB LX |
| OD EUR | 1.5% | No minimum | No minimum | Up to 3% | 5078224 | LU0850782243 | STRBODE LX |
| OD USD | 1.5% | No minimum | No minimum | Up to 3% | 5078259 | LU0850782599 | TBC |
| OD CNH | 1.5% | No minimum | No minimum | Up to 3% | 5078267 | LU0850782672 | TBC |
| OD CHF | 1.5% | No minimum | No minimum | Up to 3% | 5078291 | LU0850782912 | TBC |

Classes in red signify currently inactive but available on demand.

# Stratton Street UCITS - Renminbi Bond Fund UI

## Fund Information

| | |
|---|---|
| **Domicile / legal status:** | Luxembourg / SICAV (UCITS) |
| **Base currency of the Fund:** | USD |
| **Valuation currency:** | USD, EUR, GBP, CHF or CNH (depending on share class) |
| **Valuation/dealing:** | On every full banking day, which is simultaneously a stock exchange day in Luxembourg, United Kingdom and Frankfurt am Main. |
| **Subscription/withdrawal:** | Prior business day by 4pm (Lux time) |
| **Appropriation of earnings:** | Distributing (all share classes) |
| **Investment manager fee:** | For share classes "I" and "O": up to 1.70% p.a. of the net asset value of the share class. See table above for current annual management charge (AMC). |
| **Management company fee:** | For share classes "I" and "O": up to 0.30 % p.a. of the net asset value of the Sub-Fund subject to min. EUR 45.000.- p.a. for up to 2 share classes; for additional share classes the Management Company receives additional min. 7.500.- p.a. |
| **Other fees:** | Custodian and Paying Agency Fee, Domiciliary and Corporate Agency Services Fee, Registrar and Transfer Agency Fee: up to 0.10% p.a. of the Sub-Fund's net asset value, min. up to € 40.000 p.a. subject to Luxembourgish VAT. |
| **Front-end load:** | For share classes "OD USD", "OD CNH", "OD GBP" and "OD CHF" up to 3%. There is no front-end load currently applicable for share classes "ID EUR", "ID USD", "ID CNH", "ID GBP", "ID GBP ACC" and "ID CHF". |
| **Redemption fee:** | None |
| **The Company:** | Stratton Street UCITS |
| **Name of the Sub-Fund:** | Stratton Street UCITS - Renminbi Bond Fund UI |
| **Asset Manager:** | Stratton Street Capital LLP |
| **Management Company:** | Universal-Investment-Luxembourg S.A. |
| **Auditors:** | KPMG Luxembourg |
| **Custodian:** | Brown Brothers Harriman S.C.A. |
| **Planned distribution countries:** | UK, Austria, Germany, Switzerland, France, Belgium, Netherlands, Sweden and Luxembourg |
| *** Launch Dates:** | 01 October 2013: IDEUR launched<br>21 October 2013: IDUSD launched<br>31 October 2013: IDGBP launched<br>28 November 2013: IDCNH launched<br>16 April 2014: ODGBP launched |
| **Footnotes:** | 1. Bloomberg (as at end of month)<br>2. The holding in VTB Capital 6.95% 2022 is currently rated as sub-investment grade following on from the downgrade of the Russian sovereign which is now rated Baa2 by Moody's and BBB- by S&P (still investment grade). This VTB issue is subordinated so, although it was investment grade at purchase, it had a lower rating than our other holdings. We continue to have confidence in our Russian holdings and their expected risk adjusted returns, which factor in the current ratings, and we continue to monitor the position closely. |

## Platforms and providers

Stratton Street UCITS - Renminbi Bond Fund UI can be accessed via the following platforms and providers:

| | |
|---|---|
| Aegon | AJ Bell/SIPP Centre |
| Ascentric | AXA Isle of Man |
| Canada Life International | Cofunds |
| Friends Provident Isle of Man | Legal & General |
| Novia | Royal Skandia |
| Transact | Seven Investment Management (7IM) |
| UBS Funds Centre | |

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