LOMBARD ODIER
INVESTMENT MANAGERS

LO Funds
High Yield 2024
Newsletter IM - Professional

Global Fixed Income • Fixed Income — 30 September 2024

PERFORMANCE

30.09.2024	INCEPTION	AUM	QUARTER-TO-DATE	YEAR-TO-DATE	INCEPTION-TO-DATE	2023	2022	2021
LO Funds – High Yield 2024, (EUR) PA	17 February 2020	EUR 77 mn	3.80%	3.80%	3.76%	7.82%	-10.21%	1.96%
LO Funds – High Yield 2024, (EUR) MA			4.09%	4.09%	5.50%	8.21%	-9.88%	2.33%
LO Funds – High Yield 2024, (EUR) NA			4.19%	4.19%	6.13%	8.35%	-9.77%	2.46%
LO Funds – High Yield 2024, (CHF) PA			1.85%	1.85%	-1.30%	5.61%	-10.87%	1.74%
LO Funds – High Yield 2024, (CHF) MA			2.13%	2.13%	0.35%	5.99%	-10.55%	2.11%
LO Funds – High Yield 2024, (CHF) NA			2.23%	2.23%	0.96%	6.13%	-10.43%	2.24%
LO Funds – High Yield 2024, (USD) PA			5.00%	5.00%	12.07%	9.96%	-8.11%	2.82%
LO Funds – High Yield 2024, (USD) MA			5.29%	5.29%	13.95%	10.36%	-7.78%	3.20%
LO Funds – High Yield 2024, (USD) NA			5.39%	5.39%	14.64%	10.50%	-7.66%	3.33%

Past performance is not a guarantee of future results. Performance is presented net of fees.

LO FUNDS – HIGH YIELD 2024

MARKET REVIEW

The bull run continued for fixed income in September with the fifth straight month of positive performance, as a continued cutting-cycle-fueled rally in rates lifted all fixed income assets. Investment grade benefitted most thanks to the balance of rates and credit markets, which continued to exhibit a return of diversifying properties. At a sector level there was quite some dispersion, with pessimistic outlooks from notable autos manufacturers seeing the sectors substantially underperform, while yet again HY real estate saw substantial outperformance, being highlighted by markets as the big winner from cutting cycles amidst still cheap valuations.

September was ultimately a month of central bank cuts and broadly dovish signaling. Led by the Fed, the focus firmly shifted away from inflation concerns towards concerns around a weakening labour market. US non-farm payrolls for August was on the soft side, which clearly didn’t sit well with Fed officials on the back of having 800k jobs removed from the prior year’s employment statistics following August’s revisions. The result was the Fed starting their cutting cycle with a 50bp cut to interest rates, surprising dovishly versus economist expectations of 25bps, but actually in line with market pricing by the time the meeting arrived. Nevertheless, the move clearly underscored the Fed’s desire to get things moving at pace, and perhaps an admission that cuts should have begun at their July meeting. That said, growth metrics point to little chance of an imminent slowdown in activity, with growth for the quarter continuing to track at healthy levels.

Less urgency was shown across the Atlantic in Europe, where economies are seemingly in much more pressing need of monetary support. The ECB and UK both held rates despite flatlining growth. While the latter does indeed have a stickier inflation problem to contend deal with, Eurozone inflation is now well below target in many nations. After the Fed’s more dovish delivery, President Lagarde did seem to confirm that more easing would be coming in November, although the lack of initiative places the block at a much greater risk of falling well behind the curve.

In Switzerland, the SNB cut its policy rate by 25bps and at the same time surprised markets with an unusually explicit form of forward guidance, opening the door widely for a further cut in December. We believe the policy rate is now at the upper end of the neutral rate, i.e. at which point it is neither restrictive nor accommodative. While one more cut looks reasonable in our opinion at this stage, incoming data and currency appreciation can lead to a more dovish outcome, especially in light of the updated inflation projections, which the SNB lowered quite significantly.

Elsewhere, a new round of stimulus was launched by Chinese authorities in an attempt to reboot faltering activity. Indeed, the package was much larger and targeted than prior attempts and looks to directly

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address major structural damage caused by the misjudged deleveraging of 2021/22. Markets approved and responded with a violent rally in both onshore and offshore risk assets. Time will tell if the programme will be sufficient, but it will certainly need to be followed with fiscal measures more direct to the consumer's pocket, which has been severely depleted since the onset of the pandemic in 2020.

Geopolitical risks increased in prominence in the middle East through the month, as Israel's conflict turned to further focus on neighbouring Lebanon with targeted attacks on Hezobollah members and infrastructure. This marked quite a severe escalation in the breadth of the conflict in the region, and increase the probability of a direct confrontation with Iran. We still believe this to be against the interest of all parties, but acknowledge that these developments make the chance of an accident in the region higher and worth monitoring

On margin, we continue to favour duration, although our conviction has dropped somewhat with a lot of cuts priced into markets already and still robust growth dynamics in the US. That said ongoing cutting cycles should continue to support the asset class. We hold our preference for high quality high yield to access spread and carry with robust fundamentals as we don't consider a slowdown to be imminent.

PERFORMANCE AND PORTFOLIO ACTIVITY

In this environment, the Fund delivered a positive Q3 2024 total return for all of its share classes: USD +1.69%, EUR +1.27%, and CHF +0.59% [1].

Portfolio activity in Q3 was muted for cash bonds, with a focus on further reducing positions maturing beyond the Fund's maturity. This was done to reduce potential drawdown risk in case of increasing interest rates or credit spread widening ahead of the final maturity at the end of 2024. All proceeds from the above transactions and bonds that were called or redeemed during the quarter were reinvested in our CSA money market investment vehicle. There was no activity in our Credit Default Swap (CDS) holdings, and the Fund's leverage remains at about 45%.

Based on the performance since inception and its yield to worst as of 30 September 2024, and assuming no future realised losses on any current position, we estimate the Fund to deliver an expected annualised total return at maturity of about 3.6%, 2.1% and 0.8% for USD, EUR and CHF share classes (gross of fees), respectively. These are indicative figures and are subject to future market developments.

The average rating for the Fund's bond investments remains stable, firmly in the BBB+ [2] range. As the fund approaches maturity its average rating improves due to the increased allocation to the highly rated money market investments. Around 83% [2] of the instruments are rated in the BB range or above, as we are defensively positioned from a default/risk standpoint in the current environment.

OUTLOOK

As the Fund approaches its final maturity, its activity will focus on selling the remaining bonds that will not be called or redeemed by then. However, most of these bonds have their maturity date close to the Fund's maturity and are trading near par; therefore, this activity should have a limited impact in terms of performance. We will also continue to monitor the default risk and credit quality within the portfolio rigorously to avoid any negative outcomes as the Fund approaches its conclusion. Finally, the current yield to worst of the Fund and its defensive positioning offers attractive prospects, which should support further positive absolute performance towards its maturity.

[1] All NA share classes. Performances are net of fees.

[2] Calculated as of 30 September 2024, using the second-best rating per instrument. Where an instrument is unrated, an internal rating is assigned. All ratings refer to the instrument rating.

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