LOMBARD ODIER
INVESTMENT MANAGERS

LO Funds
Fallen Angels Recovery
Newsletter

Global Fixed Income • Fixed Income

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FIXED INCOME MARKET OVERVIEW

Much like May, June was another month of 2 halves and geographical divergence, but this month with domestic politics taking the limelight rather than the recent trend of macro data and central banks. Rates outperformed early in the month across both US and EUR, before French elections triggered a sell off in EUR assets, impacting HY the most with some spillover into the US credit space. Credit then saw some recovery into month end and remained stable despite a rather sharp selloff in duration assets into month end. Macro data and central bank activity was the focal point to start the month, kicked off by the ECB delivering a well signposted first cut in policy rates for the cycle. The bank left its options open moving forward, stressing that an ongoing cutting cycle was not the base case and that decisions would continue on a meeting-by-meeting basis. That said, inflation data continued to be around the 2-3% level in the bloc, with activity data stalling somewhat versus the rebound that had been suggested in recent months.The Fed meeting delivered no cut, but a new dot plot pointed to reduced cut expectations for the year to just 1 cut vs 3 previously, although this was aligned with market pricing. Perhaps more important was the ongoing moderation in inflation dynamics, with the inflation report for May the most dovish in quite some time. Continued inflation prints in line with the May trend, alongside the progressive moderation in consumption and activity data, would put a first cut on the radar for September.However, trumping macro data this month was political events on either side of the Atlantic. Starting in the US, the presidential news flow took a big leap to the fore following the televised debate between President Biden and Republican nominee Trump. A very weak performance from Biden saw not only a big shift in betting odds towards a Republican victory, but also brought very serious questions around whether sitting President Biden should continue as the Democrat candidate. The market implications were interesting, with a sharp bear steepening in the US rates curve. This would imply markets perceive a Trump presidency to put more pressure on the fiscal deficit and hence long-term funding costs, with cyclical fiscal stimulus to continue.Even still, the most unforeseen development of the month came in France, with President Macron calling snap government elections to stamp out the far right following huge support for Marine Le Pen's RN party in European elections. Although Macron emphasized that the vote did not put his presidency at stake, the move raised eyebrows as a sizable and unnecessary risk to the nation's political stability. European risk assets sold off aggressive and French government bonds (OATs) widened to multiyear high spreads vs German bunds, amidst concerns that a positive result for either RN or a leftist alliance would put fiscal prudence and hence financial stability at risk. The initial risk off move retraced as the likelihood of a far right or left majority looked slim, meaning a hung parliament scenario would see pushing through controversial legislation unlikely. Nevertheless, the situation remains an ongoing concern, both in France and in a wider sense of nationalistic and populist uprisings globally, which will likely only accelerate on fallout from the US election also.Despite the increase in political risks, we think technical such as investor demand for higher yields and deployable cash allocations remain broadly supportive of markets at this stage. In light of the latest moves in macro data we continue to like duration assets, but acknowledge that fiscal dynamics require continued monitoring, but is a move we expect more to materialize via steeper curves rather than outright downside across all duration assets. We very tactically see scope for a rebound in certain French names that have been impacted unduly by the election induced volatility, so currently prefer EUR credit over US to look to capture some spread recovery.

PORTFOLIO ACTIVITY

There were no changes in issuers within the Fallen Angel index in June. S&P downgraded CPI Property, a Czech-based property group with assets through Central & Eastern Europe and Germany, following the company's limited success in deleveraging and in anticipation of continued pressure on financial metrics. This action came as something of a surprise to the market as the company has been working hard to sell assets, raise liquidity, simplify the company structure and improve governance. CPI is not a constituent of the Fallen Angel index which excludes emerging market issuers. However, this is a name we have followed closely for a number of years, consider S&P's action a little harsh and believe the company will be able to operate as a "BB" entity and therefore added to the portfolio.We also added a new issue from Ceconomy, a European consumer electronics retailer. Ceconomy took advantage of recent spread tightening and robust operational performance to refinance its 2026 notes by issuing new 2029 notes - a prudent move in our opinion. We have been impressed with Ceconomy's management which is reflected in a conservative financial policy (low leverage and good liquidity) and a strategy that we expect to deliver improved margins and cash flows in coming quarters. We therefore tendered the 2026 bonds and bought the new issue which came at an attractive yield of 6.25%.

PERFORMANCE AND CHARACTERISTICS

The fallen angel strategy is a high quality high yield strategy with an average rating of BB+; some two notches better than the high yield index.The strategy under-performed both the high yield index and Fallen Angels index in June for the first time in four months. Under-performance came from security selection within the retail sector, primarily pharmacy Walgreen Boots which reported weaker than expected earnings at the end of the month and also suggested it is not pursuing a sale of UK pharmacy Boots which would have reduced the company's debt burden. We will continue to monitor the company's turnaround plans carefully.Year to date performance remains ahead of the high yield index on a gross basis which is particularly pleasing as the Fallen Angel index has underperformed the high yield index by over 100bp this year. This strong performance supports our view of the critical importance of active management and alpha generation within this strategy.

OUTLOOK

The strength of the recovery in real estate since the end of last year has been something of a surprise. However, we still expect this sector to provide a number of new Fallen Angels this year as higher interest rates continue to impact valuations and financial metrics. We also continue to expect the impact of higher interest rates & lower disposable incomes to impact adversely on companies' credit quality, particularly those in the consumer cyclical sectors (automotive, leisure excluding cruiselines, airlines etc). However, it feels currently as though new Fallen Angels are not concentrated within specific sectors but driven by company specific actions or challenges which makes fundamental analysis prior to investment in new Fallen Angels even more critical.

PERFORMANCE

30.06.2024	INCEPTION	AUM	MONTH-TO-DATE	YEAR-TO-DATE	INCEPTION-TO-DATE	5 Year Ann. Return	10 Year Ann. Return
LO Funds Fallen Angels Recovery Syst Multi Ccy Hdg USD NA	30.11.2021	USD 362 mn	0.40%	2.83%	4.29%		
Bloomberg Barclays Global High Yield Corporate ex-EM TR HDG USD			0.83%	2.86%	5.68%		

Past performance is not a guarantee of future results. Performance is presented net of fees. AUM as of the date of the table.

RISK AND REWARD PROFILE

1	2	3	4	5	6	7

Lower Risk — Higher Risk

The following risks may be materially relevant but may not always be adequately captured by the synthetic risk indicator and may cause additional loss:
Credit risk: A significant level of investment in debt securities or risky securities implies that the risk of, or actual, default may have a material impact on performance. The likelihood of this depends on the credit-worthiness of the issuers.
Liquidity risk: Where a significant level of investment is made in financial instruments that may under certain circumstances have a relatively low level of liquidity, there is a material risk that the fund will not be able to transact at advantageous times or prices. This could reduce the fund's returns.
Concentration risk: To the extent that the fund's investments are concentrated in a particular country, market, industry, sector or asset class, the fund may be susceptible to loss due to adverse occurrences affecting that country, market, industry, sector or asset class.

Before taking any investment decision, please read the latest version of the prospectus, the articles of incorporation, the Key Information Documents (KIDs) and the latest annual report and semi-annual report. Please pay attention to the Appendix B "Risk Factors Annex" of the prospectus.

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Access to documents in country of registrations:
The PRIIPS/KIDs are available in one of the official languages of your country and a Prospectus is available in English, French, German and

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