LOMBARD ODIER
INVESTMENT MANAGERS

LO Funds
Fallen Angels Recovery
Newsletter

Global Fixed Income • Fixed Income

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OVERVIEW OF THE FIXED INCOME MARKET

July was a strong month for fixed income, with all segments across USD and EUR posting their best monthly returns of 2024. Looking under the hood, a strong rate rally on pricing of an accelerating cutting cycle was the prevailing tailwind for all fixed income assets, with duration heavy assets the clear outperformers. At the same time, spreads were flat on the month, except for in EUR IG which saw spreads tighten to begin the month as French election concerns subsided. The macro nature of the move saw minimal differentiation from a sectoral point of view.Macro data continued to support the continued transition into cutting cycles, with inflation data softening along with demand data. US CPI in particular surprised below expectations, even showing a negative MoM print at the level CPI. This followed lower than expected PMI figures and an uptick in unemployment. The combination of lower inflationary dynamics and an uptick in unemployment featured heavily in the Fed's meeting at month end, with emphasis that both sides of the dual mandate are now in play. Despite not cutting rates this month, this shift of focus back onto unemployment number looked to set up for cuts beginning in September. This would bring the Fed into the cutting cycle journey that was already underway at the ECB, and also began at the Bank of England this month most notably, with the Bank of Canada adding another cut to their first 25bps in May. Moving in the opposite direction was the Bank of Japan, who hiked 15bps to 0.25%. Whilst small in magnitude, the hike signals a key ongoing reversal in monetary policy between Japan and the rest of the developed world. The ramifications of asset reallocations from Japanese investors and beyond will require close attention, with similar divergences historically triggering carry trade unwinds that can span well beyond Japanese shores and assets.As alluded to in the introduction, politics continued to generate headlines. First in France as a stronger than expected performance for Macron at the expense of Le Pen's RN party deemed to be the more market friendly outcome despite strong performance of the far left. This relieved pressure on OAT-bund spreads and French assets more generally.The US political landscape also lurched back and forth, with sitting President Joe Biden pulling his re election bid and paving the way for his Vice President Kamala Harris to run as the Democratic nominee for November's election. Whilst pressure had been rising on Biden to step aside following a disastrous debate appearance in June, a sharp increase in support for Republican nominee Trump following a failed assassination attempt seemed to force Biden's hand. Election odds are now much more evenly split, with a tighter race likely to me more inducive of heightened volatility as we move close to the vote.In international politics, late in the month ongoing tensions in the middle east again flared higher after Hamas' political leader Ismail Haniyeh was assassinated whilst visiting Tehran. The risk of direct confrontation between Iran and Israel is the key concern for the region and whilst the appetite for such conflict by both sides is limited, such moves risk forcing an unwanted escalation. Risk in the region continues to threaten a wider risk off move.

PORTFOLIO ACTIVITY

While only one new issuer joined the Fallen Angel index in July, it was an important one. Thames Water is now one of the larger issuers in the Fallen Angel universe with its weight capped at 3% by market value. Thames Water bonds were downgraded to BB at S&P and Ba1 at Moody's reflecting the challenging operating conditions faced by the company as well as liquidity concerns given current owners' unwillingness to provide further equity support. The company has also been subject to ongoing and not unjustified criticism in the financial and popular press with numerous options being "discussed" including "failure" and "nationalisation". Our current is that Thames will likely be subject to a special measures regime which imposes various restrictions on the company and that the company, OFWAT (the regulator), shareholders and the government will ultimately come to an agreement that ensures Thames survival so that UK water and other regulated sectors (electricity, gas etc) remain attractive to private investors. However, the position remains uncertain and will be for some time. We do not consider Thames to be a Falling Knife but remain cautious and have estimated a recovery value for the bonds at around 75% which will form a critical part of our investment decision.Two Delta Airlines bonds left the Fallen Angel universe following the upgrade to BBB- by Fitch. The upgrade reflected a post COVID improvement in credit metrics with gross debt reduced by c. USD11bn over the past three years and a conservative financial policy expected to be maintained. We added the only outstanding bond of Italian real estate company, Immobiliare Grande Distribution (IGDLN). This is a bond we have been looking to add to the portfolio for some time as it has some very supportive credit features but has been difficult to source. It was issued in November 2023 in exchange for the existing Fallen Angel bonds maturing in 2024 offering a higher coupon as well as a number of features to encourage the company to repay it early including compulsory partial repayment from asset sales, annual coupon step up of 100bp and an increasing call price. We note that operational performance is solid so we are happy (and indeed would prefer) to hold the bond to maturity but will also benefit if the company calls the bond having acquired the position at less than the current call price.

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 the high yield and the Fallen Angels indexes in July. As in June under-performance came from security selection within the retail sector. Macy's discussions to take itself private failed which led to some weakness as it became clear the change of clause allowing investors to put the bonds back to the company at a price of 101 would not be triggered. This, combined with perceived consumer weakness led to weakness across a number of other US retailers such as Kohl's, Walgreen Boots and Nordstrom. French retailer Auchan was also downgraded one notch to BB by S&P following continued weakness in its French retail operations. A modest position in the class B Thames water bonds also contributed negatively which we have now exited preferring to have exposure to the senior secured class A notes which have materially higher recovery values.Year to date performance remains in line with the high yield index on a gross basis following this months under-performance which is 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.

OUTLOOK

Duration was the ultimate winner of the month, but we feel there is further room to run as cutting cycles continue and perhaps even pick up pace. We acknowledge increasing risks from diverging monetary policy backdrop and increased political uncertainty, particularly in the face of reduced summer liquidity, however continue to support selectively accessing high yield through higher quality. Through such conditions we emphasize the need to focus on core fundamental trends, which as of now show slowing, but not collapsing demand, with earnings continuing to come in robust, albeit at slower growth rates the previous quarters.

PERFORMANCE

31.07.2024	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 371 mn	1.07%	3.93%	5.41%		
Bloomberg Barclays Global High Yield Corporate ex-EM TR HDG USD			1.81%	4.72%	7.59%		

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.

Incorporation of extra-financial risks into the investment decision process may result in underweighting of profitable investments from the sub-fund’s investment universe and may also lead the management of the sub-fund to underweight investments that will continue to perform. Sustainability risks may lead to a significant deterioration in the financial profile, profitability or reputation of an underlying investment and may therefore have a significant impact on its market price or liquidity.

The Fund has been classified as a financial product subject to Article 8 of Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial sector (the “SFDR”). The Fund promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices.

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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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