Letter to Shareholders – Value Bonds

Q3 2015

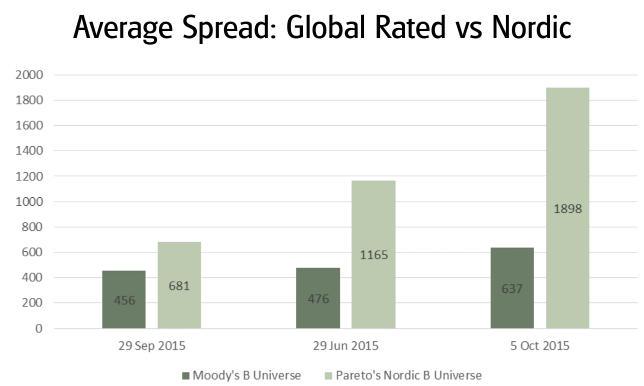
Dear Investor,

Our High Yield bond strategies have been facing a very difficult environment over the last four quarters which has further worsened in Q3 2015. Our High Yield funds have, historically, been constructed to focus on asset backing, strong covenants and high coupons. When everyone was chasing High Yields (2010-2014) few companies were forced to provide asset backing and covenants to their bond investors. Nordic bond issuers operating in the oil & gas space were amongst the few who did provide asset coverage and strong covenants. As there were limited alternatives providing similar levels of investor protection, the strategies ended up with excessive concentration in these sectors. This proved disastrous in the wake of the oil price collapse – as seen with our High Yield performance. High carry across the fund did not provide the protection for such underperformance.

With oil priced at 50% of where it was 18 months ago, having bond positions in the oil and gas sector was equivalent to having the security of a luxury car stuck in the sand (pic 1). Continuing with the analogy, with some success we managed to pull a car or two out of the sand (pic 2). What happened subsequently, however, is that by the end of Q3 2015 we were surrounded by cars stuck in sand all over the place (pic 3). In some cases the cars are still moving, in others the wheels are spinning and some have already been swallowed by the tide. There are bargains to be had in this environment, but it will take time to pull out and clean these cars. Now that the whole beach is full of stuck cars, the discount on them increases as there are only so many tractors out there. Our strategy going forward is very clear, avoid getting cars in the sand and make the best of those already stuck.

Away from the distressed Nordic bond market, global High Yield markets turned negative in terms of both year-to-date returns and sentiment. (Global High Yield and Investment

Grade benchmarks are down 1.7% and 0.4% YTD.) The negative sentiment can be attributed to the following: weakness in the Chinese economy (as compared to historical growth rates) led to significant repricing in the commodities space, where China has historically been a huge buyer. At the same time, indications of the first interest rate increase in the USA since 2006 has led investors to reduce their appetite for the marginal credit class: Emerging Markets debt. Through the quarter we have been building up cash across our strategies to take advantage of weakness as we saw the discrepancy between opportunities in the Nordics and international markets. Now both have become cheaper. It is at times of stress that bottom-up investors can take advantage of the opportunities available, so we are very excited about the current environment when looking to deploy our built up cash balances.



The chart above shows the explosion in spreads in the Nordics compared to widening in Moody's Global B Rated bond universe; Source: Pareto Securities.

Investment Grade Strategies

Our Investment Grade strategies underperformed the benchmarks during the quarter on average by 1.5% gross of costs. Both the relative and absolute underperformance was driven by our overweight in lower rated BBB bonds, including our holdings of subordinated debt. Rising risk premiums resulted in a drag on our Investment Grade fund performance. The biggest single underperforming position has been our 1.9% position in VW perpetuals which have seen price drops in excess of 15%. We continue to hold the bonds and follow the case closely. Ahead of the possible rate increase in the US and continued commitment to Quantitative Easing in Europe, we believe the Investment Grade funds are attractively positioned with their overweight in Europe and short duration positioning. We continue to run the funds with higher credit risk (approximately 1.5x that of the benchmark) and pick up additional carry versus our benchmarks.

At time of writing our Investment Grade Value Bonds fund is performing on par with benchmark on year-to-date performance, gross of fees, and has a 5 star rating from Morningstar.

Maturity Strategies

Our Maturity Strategies consist of funds with holdings in both High Yield and Investment Grade bonds that mature before the final maturity of the specific fund. Our range of funds and maturity mandates have maturities between 2015 and 2019. We believe this is an attractive format to invest in High Yield in a rising interest rate environment, especially given the continuously poor liquidity in credit markets. Each fund has a unique portfolio construction. As a result, any overlap with sister funds will vary and so will the performance of the individual funds.

Funds with 2017 maturities have been the weakest performers with losses of between 2.7% and 5.9% during the third quarter of the year. The majority of the underperformance has come from bonds issued out of the Norwegian market with exposure to oil & gas services or commodities. We continue to hold the majority of these bonds and have crystallised losses only in instances where we thought prospects of recovery were limited or where we expected significant loss potential without a blue-sky refinancing scenario. The underperformance has been further amplified by the short-dated nature of the holdings, as refinancing in the market is currently closed for anyone in these sectors with an upcoming maturity.

Our best performing strategies have been our 75% High Yield and 25% Investment Grade funds, launched with 2018 target maturities. Performance at quarter end was on average 1% gross of fees. The funds did not escape the impact of the repricing in High Yield where energy or commodity-related names in particular contributed negatively.

High Yield Strategies

Q3 was a terrible period for High Yield with a loss of 4.6% for the Global High Yield benchmark. Our funds' underperformance of between 1.5% and 2.7% compared to benchmark was driven by significantly their higher level of risk and exposure to oil & gas services sector in Norway discussed above. The divergence in performance between funds is driven by certain distressed situations which relate to the holdings of individual funds.

Our relatively high levels of cash entering the summer period provided some cushioning to the underperformance but could not protect us from the swings in the oil & gas services sector, which were primarily driven by the oil price hitting a price of $40 per barrel.

Our exposure to commodities (copper, coal and gold among others) was a further drag on performance. Commodities have hit 14-year lows and any producers with high debt levels have seen their bond prices drop.

Bloomberg Commodity Index (BCOM)

The chart above shows the significant drop in commodity prices that has been taking places in the recent quarter but also over the longer period, Source: Bloomberg.

Going forward, due to our Nordic exposure, performance will be driven by the working out and restructuring of these situations, as opposed to wider credit market moves. Having exposure to hard assets with valuations at 70% discounts to initial build costs, we see significant upside built into these portfolios.

Emerging Market Strategies

Q3 was a weak quarter for Emerging Markets with a loss of 2.9% for the JPM benchmark. Our funds underperformed between 2.0% and 5.2% versus benchmark, driven by our high yield focus, i.e. significantly higher level of risk in the funds and our exposure to the oil & gas services sector. The divergence in performance between funds is driven by certain distressed situations relate to the holdings of individual funds.

Our overweights in Eastern Europe performed well, as Chinese slow down fears and FX fears drove weakness across Asia. We did, however, underperform on our metals & mining exposures in addition to our oil & gas exposure. With significant fear built into the market and first net capital outflows from EM markets since 1998, there are enough drivers to create significant opportunities across the EM space. We are very excited about the opportunities out there, which will be driven by commodities and also by fund flows in the short term.

Final Remarks

Historical Returns
(Nordic "CCC" vs Global HY Benchmark)

This chart shows that current last 12 month losses in CCC rated Nordic bonds are on par with losses sustained during the 2008 financial crisis.

Our exposure to Nordic bonds has cost our funds in performance. But now, after close to 12 months of negative performance and rock bottom valuations, I dare say we are hitting the lows and it will be source of performance. Yes, oil may halve from here, which no doubt would result in more panic selling, but we have reached equivalent or even lower market levels than those experienced in the crisis of 2008.

This edition concluded on 9 October 2015.

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