Kames Absolute Return Bond Fund

April 2017 review

KAMES CAPITAL

For professional investors only

3 May 2017

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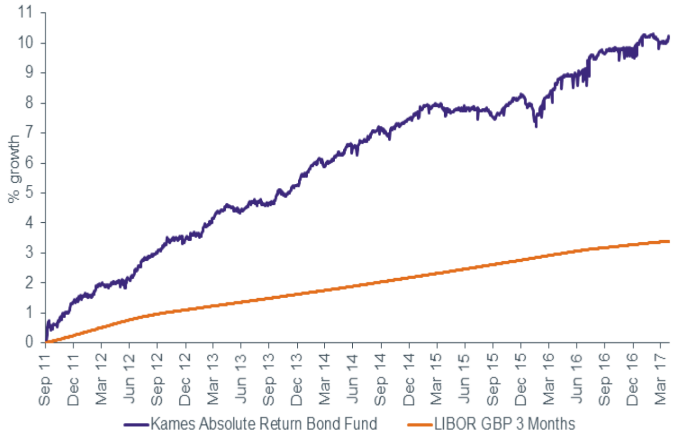
The Kames Absolute Return Bond Fund returned 0.13% in April, outperforming the 3m GBP LIBOR return of 0.03%. This takes the year-to-date return to 0.33% compared to 0.12% for LIBOR.*



Total since launch

Fund total return	10.18%
Benchmark total return	3.40%
Difference	6.68%
Best month	0.60%
Worst month	-0.31%
Up months	48
Down months	19
Maximum drawdown (daily)	-1.00
Volatility	0.69
Sharpe ratio	1.66

*Source: Lipper as at 30 April 2017, net and noon prices. NAV to NAV total return with income reinvested. Local currency B (Acc) GBP class. Launch 30 September 2011. Since launch return is based on Cumulative Noon Lipper data. Benchmark is at close. Risk Statistics based on net annualised monthly returns. Maximum Drawdown has been calculated as the largest peak-to-trough cumulative fall based on daily returns.

April was another month where financial markets were focused on politics and geopolitical risk, helping to fuel uncertainty and volatility in bond markets. Following the failure to repeal the Healthcare Act, President Trump's decision to take military action against Syria and to verbally spar with North Korea only served to fuel the risk off sentiment. Having touched 2.40%, 10-year US Treasury yields then fell to 2.15% before moving higher into month end.

Part of this move was driven by a reassessment of the Trump "reflation" trade, with expectations falling on what "pro-growth" policies can and will be enacted. It was also influenced by French election. Although opinion polls were consistent ahead of the vote that Macron would lead after the first round and face Le Pen in the second round, the market continued to hold its breath up until voting day. The collective sigh of relief after the result saw core rates markets sell off in the days that followed, with10-year Bunds backing up 15bps, while French OAT's rallied 12bps. With the second vote only days away, the market and the opinion polls are both confident of a comfortable Macron victory – if that is the case, the hard work may only be beginning, as attempts are made to form a new Government and the promises of reform are tested. While this part of the European political story may be coming to an end, the announcement of a snap General Election in the UK will ensure that political risk remains a key driver of bond markets in the months ahead.

Credit

The Credit module had a good month adding value through a number of positions. The standout trade over the month was our long risk iTraxx Main (euro investment grade) vs short risk CDX IG (US investment grade). In line with the optimism surrounding the new US President and the reflation trade, US corporate bonds had outperformed their European equivalents with the euro market also suffering from the uncertainty surrounding the French election. We felt the move was overdone, particularly given our expectation of an orderly first round of voting. The result of the election was the catalyst for a sharp outperformance of European assets with our trade quickly moving to our profit target – as such we closed the position and banked the profit.

We also benefited from a couple of single name CDS positions that were long French banks. Both our long risk BNP vs short risk Barclays and long risk Societie Generale vs short risk Standard Chartered moved in our favour after the first round of the French election. Both feel like they have further upside and, as such, we are happy to hold them.

Elsewhere, there were also gains from the collection of short-dated bonds that we hold against a credit and duration hedge. These holdings reversed the weakness we saw last month and added value to the module and Fund. Alongside this, our basis trade involving UBS subordinated debt also helped boost performance.

Rates

The Rates module also had a positive month in April. The Fund benefited, in particular, from new positions that were added over the period. Early in the month we opened a long position in ultra-long dated UK index-linked bonds vs 10-year UK bond futures. The long end of the UK index-linked market had been weak, leaving them cheap compared to medium dated assets, which prompted the trade to be opened. In the days that followed, the 2068 maturity bonds that we held rallied sharply, outperforming 10-year gilt futures, aided by strong demand for long-dated sterling assets. This move allowed us to close the trade profitably.

We also added a long 10-year US Treasury vs short 10-year Australia position. The Australian bond market had been trading very strongly on a relative basis, supported by more mixed domestic data and a central bank that was increasingly looking towards macro prudential tools, rather than interest rates, to cool its housing market. This move caused rate hike expectations to dissipate and the 10-year bond spread to compress to only 18bps vs US Treasuries. This allowed us to open a position to oppose that move, with the increase in the spread that followed generating alpha for the Fund.

On the negative side we closed out our long 15-year Spain vs short 10-year Italy position at a loss. As we approached the French election we became nervous that a Macron victory could be more supportive for Italian than Spanish bonds, particularly given that positioning in Italian BTP's is generally short. With this in mind, we closed the position to protect against further losses. We did come back to Spanish bonds again at the end of the month when we added exposure to 10-year Spanish inflation-linked bonds against 10-year French OAT's. We see scope for inflation in Europe to surprise to the upside and the issue of a new Spanish index-linked bond offered an attractive entry point. Selling French futures on the other side allowed us to sell assets that look to be fully valued ahead of the second round of the French election.

Carry

The Carry module had a solid month. This module invests in investment grade rated bonds with a final legal maturity of less than two years – these are held overwhelmingly on a buy and hold basis without any interest rate or credit hedge. Our holdings benefited from the return of some composure at the short end of the UK curve, following a bumpier ride in March.

Colin Finlayson

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The Kames Absolute Return Bond Fund is currently authorised for distribution in the UK; Channel Islands; Ireland; Luxembourg; Switzerland; Malta; Germany; Austria; Belgium; the Netherlands; Spain, Italy and Sweden. Not all available share classes are registered in every country. Refer to the full prospectus for details.

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