Stratton Street UCITS - NFA Global Bond Fund UI

March 2017

- **Positive month for bonds; Fund's QDUSD class gained 0.79%**
- **Fed increased rates 25 basis points in a widely expected move**
- **10 year Treasury yield unchanged over the month and credit markets well supported**
- **US dollar retraced some of the previous month's gains**

Market Comment

The 25 basis point Fed rate hike was so clearly flagged to the market that it ended up being a non-event, although the market drew some comfort from a perceived dovish tone to the FOMC minutes and Janet Yellen's comments which talked of near-term risks as being 'roughly balanced'. On the back of this, the 10 year US Treasury yield was unchanged at 2.39%. The failure of Donald Trump to get his Health Care Act passed on the first attempt highlighted the gap between campaign rhetoric and what is likely to get approved by Congress. Clearly, tax reform and deregulation were also major election promises and will be keenly watched to see what can actually be implemented.

In Europe the election season kicked off with the Dutch election. The incumbent Prime Minister Rutte's party gained the largest number of seats and began the process of forming a coalition government. In the run up to this, bond markets had been pretty sanguine about the risk of Geert Wilders' anti-establishment, anti-immigration, anti-euro far-right Freedom Party (PVV) gaining a grip on power most likely as the Netherlands' proportional representation system was going to deliver a fragmented outcome and require a coalition government mitigating a lot of risks. But this push-back against populism also helped improve sentiment in other sovereign bond markets, notably France where the first round of the Presidential election is due in April. Towards month end, the UK triggered article 50 of the Lisbon Treaty to start the process of withdrawing from the EU but his had been widely expected.

Investment grade credit spreads were little changed on the month and Middle Eastern and Russian bonds remained well supported despite Brent crude prices ending the month down: a £850m 7 year sterling bond from Gazprom on a 4.25% yield was well received with the book approaching two times covered.

Portfolio Review

The Fund's QDUSD class gained 0.79% net of fees over the month outperforming the JP Morgan Global Aggregate Bond Index (USD) which fell 0.01% over same period. Year to date the QDUSD class is up 3.59% against a 0.91% return for the JP Morgan GABI index.

Over the month, the holdings in Pemex 6.635% 2035, the quasi sovereign oil producer 100 percent owned by the Mexican government, and the United Mexican States 4.6% 2046 were amongst the top performers contributing 23 basis points to performance. Given that Pemex 5.5% 2044 still trades at a yield off 6.39% versus 4.85% for the US dollar denominated United Mexican States 4.6% 2046 issue there is still scope for the Pemex curve to converge closer to the sovereign. The United Mexican States 4.6% 2046 has been a strong performer with the spread over Treasuries having tightened leaving the bond trading 1.9 notches cheap on our models.

A bond issue from Sultanate of Oman got off to a good start likely reflecting its attractive yield: 10 and 30 year maturities were added to the portfolio. The portfolio's Oman holdings contributed a total of 22 basis points to performance. We still see scope for further upside: For example, the Oman 6.5% 2047 issue still trades on a yield of 6.02% and is trading 3.7 notches cheap on a best rating basis.

The Kingdom of Saudi Arabia's bonds remained resilient despite Fitch cutting the sovereign's rating by one notch to A+ (stable outlook) to reflect the deterioration in the fiscal and external accounts and reform implementation risks. Our proprietary models already had the Saudi Arabia 4.5% 2046 issue trading close to 4 notches cheap prior to the cut and the quasi sovereign issue of Saudi Electricity (5.06% coupon with a 2043 maturity) as much as 4.9 credit notches cheap suggesting the market had already factored this in to a large degree.

Gazprom issued a £850m 7 year sterling bond on a 4.25% yield which on a best rating (BBB- Fitch) basis is trading over 3 credit notches cheap on our models tempting us to add a small position. We also added a small position in the Kuwait 3.5% 2027 issue reflecting the issuer's strong credentials (Aa2 rated) but less valuation upside according to our models which has it trading ~2.5 notches cheap.

Outlook

For us, June looks to be very much a live meeting for another rate rise. Barring any slowdown in the economic data points, we would expect the Fed to continue with two additional 25 basis point hikes as the year progresses. That said, our proprietary models suggest that the 10 year US Treasury yield at 2.33% is already discounting this. Predicting the path of interest rates in the US beyond that is difficult without more detail on Donald Trump's policies and knowing what he can get approved by congress, particularly in light of the recent setback in trying to pass the Health Care Act.

Our view remains that the yield curve will flatten and we favour positioning at the long end of the yield curve. Even if the Fed were to pursue a more aggressive interest rate path advocated by more hawkish members this would benefit our longer dated exposure, unless it is due to inflation accelerating, but we see this as unlikely.

The issue of reinvestment and the Fed Balance Sheet seems to becoming more topical and the March Fed minutes provided some colour noting most participants 'judged that a change to the Committee's reinvestment policy would likely be appropriate later this year.' We agree with William Dudley, the New York Fed President's recent comments that tapering would also need to be factored into interest rate decisions: 'I would expect that, when we begin to end reinvestment, we will have to consider the implications for the appropriate short-term interest rate trajectory.' We feel the Fed favours a strategy of letting bonds roll off, they will not be selling securities, and they will let the market know 'well in advance of an actual change', most likely later this year. But this debate is set to continue over future Fed meetings.

In terms of credit, while spreads in investment grade credit may not tighten significantly from current levels we still see scope for valuation upside by targeting undervalued credits with several notches of credit cushioning versus their rating and which trade on attractive positive yields. The portfolio trades ~3.6 credit notches cheap with a gross redemption yield of 4.32%.

Historical Performance[1]

	2017 %	Inception %
QDUSD	3.59	4.33
QAUSD	3.59	4.08
QDGBP hedged	3.40	4.01
QAEUR hedged	3.13	4.15

Performance Summary[1]

Index	Monthly Return %
Stratton Street UCITS – NFA Global Bond Fund UI QDUSD	0.79
JPMorgan Global Aggregate Bond Index (USD)	-0.01

Fund Prices[1]

Institutional Class	Price	Monthly Return %
QDUSD	104.33	0.79
QAUSD	104.08	0.78
QDGBP hedged	104.01	0.67
QAEUR hedged	104.15	0.59

Portfolio Statistics

Gross Redemption Yield	4.32
Gross Running Yield	4.77
Fund NAV (USD Millions)	78.67
Number of holdings	47
Number of countries	12
Duration	8.87

Fund Breakdown

Net Foreign Assets		Entity Type	
Rating	% NAV	Entity	% NAV
7 Star	39.08	Sovereign	29.32
6 Star	18.83	Quasi	54.73
4 Star	15.82	Supra	-
3 Star	24.01	Corporate	13.69
Total	97.74	Total	97.74

Credit Rating	
Rating	% NAV
AAA	2.84
AA	29.96
A	40.14
Baa	24.80
Total	97.74

Portfolio Exposure by Country	% NAV
Abu Dhabi	4.43
Chile	4.14
China	12.62
Hong Kong	1.38
Kuwait	1.93
Mexico	12.41
Oman	6.21
Qatar	19.88
Russia	11.68
Saudi Arabia	11.46
United Kingdom	4.49
United States	7.11
Total	97.74

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Share class information

Class	AMC	Minimum Subscription	Subsequent Investment	Front-end load	WKN	ISIN	Bloomberg
QAEUR hedged	0.60%	EUR 500,000	None	Up to 3%	A2AQ20	LU1483930282	SNFAQAE
QAUSD	0.60%	USD 500,000	None	Up to 3%	A2AQ2Z	LU1483930100	SNFAQAU
QDGBP hedged	0.60%	GBP 500,000	None	Up to 3%	A2AQ2Y	LU1483930019	SNFAQDG
QDUSD	0.60%	USD 500,000	None	Up to 3%	A2AQ2W	LU1483929862	SNFAQDU
RDEUR hedged*	1.10%	No minimum	None	Up to 3%	A2AQ22	LU1483930449	TBC

* Class not yet activated but available on demand

Fund Information

Domicile / legal status:	Luxembourg / SICAV (UCITS)
Base currency of the Fund:	USD
Valuation currency:	USD, EUR, GBP (depending on share class)
Valuation/dealing:	On every full banking day, which is simultaneously a stock exchange day in Luxembourg, United Kingdom and Frankfurt am Main.
Subscription/withdrawal:	4pm (Lux time) on the business day prior to the relevant Dealing Date
Redemption fee:	None
The Company:	Stratton Street UCITS
Name of the Sub-Fund:	Stratton Street UCITS – NFA Global Bond Fund UI
Asset Manager:	Stratton Street Capital LLP
Management Company:	Universal-Investment-Luxembourg S.A.
Auditors:	KPMG Luxembourg
Custodian:	Brown Brothers Harriman (Luxembourg) S.C.A.
Launch Date Fund:	30th November 2016
Launch Date Class:	QAEUR hedged & QDGBP hedged 30th November 2016, QDUSD 9th December 2016, QAUSD 13th December 2016

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[1] Source: Bloomberg and Stratton Street calculations. All returns are calculated net of fees and include dividends re-invested, data as at end Jan-2017.
Past performance is not a reliable indicator of future performance.