Nordea ASSET MANAGEMENT

CORPORATE CREDIT – QUARTERLY NEWSLETTER

Third quarter 2017

Q3 2017 Market Review and Outlook: Another risk-on credit market

Main highlights

- **EU:** A positive quarter for European credit despite raising geopolitical tensions between the US and North Korea. The ECB remains in focus as the president Mario Draghi signalled that the future of European QE will be largely decided during the October meeting
- **US:** Demand from yield-seeking investors continues to provide a strong technical tailwind for the US corporate bond market. While the Federal Reserve will officially start its tapering program in October 2017, the financial health of the broad investment grade and high yield corporate issuer base remains sound
- **EM:** Emerging markets corporate debt produced positive returns in the third quarter, with underlying corporate and macro fundamentals remaining supportive as investors continued to search globally for higher-yielding securities. Signs of an increase in global growth manifested in the period as well

Europe

Investment Grade by Nordea

The third quarter started with a bit of volatility in the credit market on the back of a speech made by European Central Bank President Mario Draghi being perceived more hawkish than previous speeches by the market. This caused a small sell off in government bonds as well as the equity and high yield markets. Investment Grade bonds, on the other hand, continued to tighten through the wobble.

The market volatility came down relatively quickly through the July summer lull and well into August when volatility picked up again following the geopolitical tensions between the United States and North Korea related to missile tests. As the situation evolved credit spreads crept wider before turning around in September when a stronger equity market helped sentiment and spreads resumed the tightening trend towards the end of the quarter. With September ending on a strong note spreads tightened 5 basis points (bps) during the third quarter.

Over the third quarter, the covered bond market returned slightly positive returns, +0.44 % as measured by the iBoxx EURO Covered Bond Index. With an overall quiet summer, markets were expecting news on possible changes to ECB's QE programme in September, but the ECB President Mario Draghi did not yet disclose any details on tapering. In terms of issuance, July and August levels remained low as expected in this period of the year. In September, the covered bond markets kicked off with EUR 10bn issuance. Though this is a significant increase compared to the last couple of months, it is still a modest amount when looking at the historical issuance in September. Most deals were from core countries like Germany and France but we also saw some issuance from Italy, Portugal, Poland, and Singapore. All issues were well received by the market and did not put pressure on spreads.

High Yield by Capital Four Asset Management A/S

The option adjusted spreads (vs. Govt, including rebalancing) of the European High Yield market (EHY) tightened 24bps to 278bps during the third quarter, leading to a +1.69 % market return. The strong performance and low volatility witnessed in the first two quarters of the year continued in the third quarter. The stable and positive returns came despite intensifying geopolitical tensions between North Korea and the US.

During the quarter the European high yield market has slightly outperformed the US high yield market (in EUR-hedged terms). This is an impressive result if we consider the strong increase in the oil prices: commodity-related credits are in fact a relatively large part of the US high yield market compared to the European high yield market.

Interest rates in Europe were more or less flat throughout the quarter, yet with significant intra-quarter fluctuations. There was a lot of activity in the primary market during Q3 despite a slow August, with EUR 22bn of new issuance bringing YTD supply up to EUR 68bn (vs. EUR 47bn over the same period last year). Around 50 % of the newly issued bonds was senior secured, a relatively lower portion when

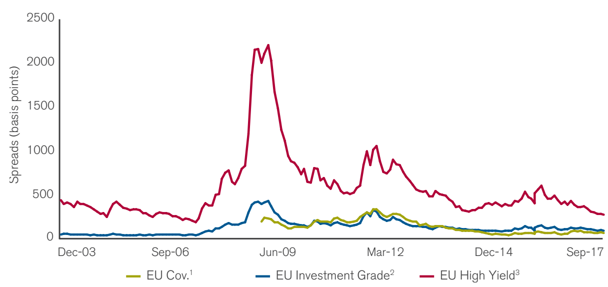
* investing for their own account – according to MiFID definition

compared to the two previous quarters. European High Yield mutual fund flows during the quarter were negative, implying negative year to date flows as of September end as well. Even though it was the highest returning month in the quarter, the biggest outflows were recorded in July.

In Q3, the returns of the different benchmark rating categories were: BB +1.6 %, B +1.6 % and the CCC-rated bonds returned +3.8 %. The best performing sectors were Insurance, Energy and Real Estate while the worst performing sectors were Telecom, Capital Goods and Services.

We remain constructive on the fundamental outlook on European High Yield as we continue to see decent economic growth in the European economies (despite a difficult political environment), continued reasonable fundamentals of European companies as well as a bias for high quality and relatively modest leverage in the new issue market. Defaults remain very low (below 1 %) and estimates from sell-side strategists continue to indicate very low default rates going forward.

EU Covered vs. Investment Grade vs. High Yield market



As of 30.09.2017	EU Cov.[1]	EU IG[2]	EU HY[3]
Q3 2017 performance in %	**0.44**	**1.13**	**1.69**
Credit spreads (bps)	72	98	278
Yield to worst in %	0.45	0.80	2.70
Duration in years	4.63	5.21	3.34

1) iBoxx EUR Covered Bond Index Source: Analytics. Date: 30.09.2017. 2) Merrill Lynch EMU Corporate Bonds Index. Source Bloomberg (ER00 ticker). Date: 30.09.2017. 3) Merrill Lynch European Currency High Yield Constrained – Total Return Index (100 % EUR Hedged). Source Bloomberg (HPC0 ticker). Date: 30.09.2017. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.**

US

Investment Grade & High Yield by MacKay Shields LLC

Risky assets including US stocks, investment and non-investment grade credit benefitted from investors' optimism about the proposed Republican tax plan, an increase in oil prices, buoyant job growth in the US, and a positive global economic backdrop as the third quarter ended.

Brent crude oil rallied approximately 30 % since last June and reached levels not seen since July of 2015. West Texas Intermediate (WTI) crude also rallied above USD 51 a barrel allowing many US shale producers to hedge some, if not all, of their near-term production.

The US Treasury yield curve flattened with interest rates rising more for two- and five-year bonds than ten-year debt. LIBOR closed near 1.33 %.

The Organization for Economic Cooperation and Development (OECD) announced that all of the 45 countries it tracks are growing economically in 2017; this is the first instance of simultaneous global growth since 2007. Concurrently, the IMF increased its global growth forecast to 3.5 % for 2017 – up from 3.2 % in 2016. Japan, Brazil, Spain, and Italy were among the countries to post improved economic numbers during the month thus providing some reassurance for investors worried about the future trajectory of Chinese and US growth.

US manufacturing is expanding at the fastest clip in six years and consumer sentiment is high. Weather, geopolitics, and presidential tweets were not as friendly for risky assets, at least temporarily, as the global economic results cited above. Hurricane Harvey devastated Houston, Texas. The Caribbean and Florida were buffeted by Irma and Maria struck soon after. Additionally, tensions escalated on the Korean peninsula. North Korea continued to expand and test its nuclear arsenal and fired a missile over Japan prompting Trump to threaten "dire consequences".

The Federal Reserve announced that, effective this October, it will begin its tapering program. The program will reduce the Fed's holdings of US Treasuries by USD 6 billion a month and agency mortgage-backed securities by USD 4 billion a month. The decision was unanimous and widely telegraphed to markets. Although the FOMC left short-term rates unchanged after its September meeting, the markets attach a high probability of a final 2017 rate increase after the December meeting. Chairwoman Yellen noted that "it would be imprudent to keep monetary policy on hold until inflation is back to 2 %." Other central banks were in the news as well.

US corporate spreads tightened 7 bps during the quarter, with much of the compression coming in September, according to Barclays. Higher beta industries such as telecommunications and energy led the way as did lower quality BBB rated issues. Demand from yield-seeking investors continues to provide a strong technical tailwind for the US corporate bond market, and issuers have taken advantage of this demand through issuance. The financial health of the broad investment grade corporate issuer base remains sound while valuations further compress.

High yield spreads tightened 21 bps during the quarter, led by lower quality securities, according to Bank of America Merrill Lynch. The energy sector was the clear winner as investors continued to chase yield. Telecom (satellites) and electric utility companies also performed well while food & drug retailers, wireline and health facilities lagged. US HY bond issuance reached USD 255.6bn for the calendar year with 59 % of the total represented by refinancing activity, based on data provided by JPMorgan. Meanwhile, US HY mutual funds have experienced USD 11.1bn billion in redemptions for the year. Credit fundamentals of the non-investment grade market remain broadly sound, but we continue to be wary of the disruptive forces across a variety of industries that have led to an increase in idiosyncratic risk.

While we believe the markets continue to embrace the 'reflation trade,' we expect US economic growth to slow over the coming months. The Federal Reserve began its path of tighter monetary policy in December of 2015. Typically US economic growth slows substantially 24 to 36 months into a tightening cycle. While we do realize that the pace of tightening has been unusually slow and therefore the lag could be greater, we also realize that the Federal Reserve has had to use every tool at its disposal just to achieve moderate credit growth, which is the fuel of all expansions. Given this relatively slow credit growth, it is not too hard to imagine that credit might be more sensitive to tightening monetary policy than has been the case in the past.

From a technical perspective there are also many signs that we are in the later stages of an expansion. Both high yield and high grade spreads have narrowed dramatically over the past year and the S&P 500 trailing price-to-earnings ratio is near a record. Markets participants are indiscriminately chasing returns which is typical of the final stages of a rally. While spreads could continue to tighten further, incremental risk is being rewarded less and less.

US Investment Grade vs. High Yield market

As of 30.09.2017	U.S. IG[4]	U.S. HY[5]
Q3 2017 performance in %	1.35	2.02
Credit spreads (bps)	96	356
Yield to worst in %	3.08	5.47
Duration in years	7.29	3.62

4) Barclays Capital US Credit Index. Source: © 2017 Barclays Bank PLC. All rights reserved. Member SIPC. Date 30.09.2017. 5) Merrill Lynch US High Yield Master II – Total Return Index. Source Bloomberg (H0A0 ticker). Date: 30.09.2017. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.**

Emerging Markets

Emerging Corporates by T. Rowe Price International Ltd.

Emerging markets corporate debt produced positive total returns of 2.11 % in the third quarter, as measured by the J.P. Morgan CEMBI Broad Diversified index. Underlying corporate and macro fundamentals remained supportive as investors continued to search globally for higher-yielding securities. The U.S. Treasury yield curve modestly flattened and oil prices increased, supporting risk sentiment. Market technicals remained relatively balanced throughout the quarter. Consistently strong inflows this quarter provided ample support for steady new supply.

The benchmark's yield to maturity decreased from 5.09 % to 4.99 %, as spreads tightened and U.S. Treasury yields modestly increased. Corporate credit spreads approached the tightest levels since the end of the global financial crisis and have shown a notable decline in volatility. This is due, in part, to the stable fundamental backdrop, which likely keeps credit spreads in a more narrow range over the near term and limits the potential for a sharp correction in valuations. The index default rate is at the lowest level in the past six years. On average, high yield issues outperformed investment-grade securities, though both were positive. All corporate sectors gained for the quarter, led by advances in the metals and mining, transportation, and oil and gas sectors. African and Latin American corporates produced the strongest returns, with all regions contributing to gains.

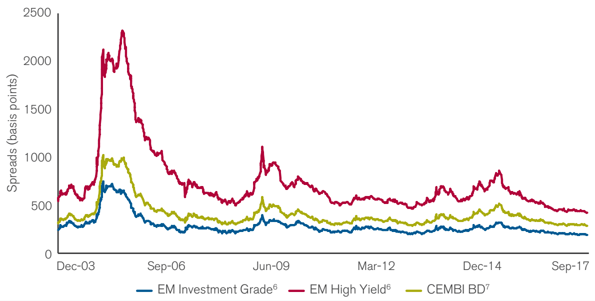
Emerging markets corporate bond gross issuance for the quarter was USD 114bn. Asian issuers accounted for the majority of new quarterly supply. New issues from investment-grade companies continue to outpace those from high yield. The market forecast for annual gross issuance for 2017 was increased to USD 440bn from USD 380bn given elevated new issuance in the year to date.

Emerging markets countries maintain a positive growth premium relative to developed markets, anchored by growth in Asia. Forecast growth for emerging markets countries in 2017 and 2018 is 4.6% and 4.9% respectively. This growth premium is expected to modestly increase to 3% in the coming years, slightly above its long-term realized average, as painful recessions in Brazil and Russia begin to ease as the difficult adjustments the countries are making begin to take hold.

Signs of an increase in global growth appeared. The International Monetary Fund raised its annual growth forecast for China for the next three years in recognition of reforms to capacity and its currency. China reported second-quarter growth of 6.9%, beating forecasts. Reserves increased, and manufacturing data were positive ahead of the national party's congress this fall. Ratings agency S&P, however, cut China's sovereign credit rating for the first time since 1999, lowering it to A+ due to concerns about rising debt levels. Russia reported higher-than-expected second-quarter growth, despite economic sanctions.

Brazil continued to enact reforms as it addresses economic challenges amid ongoing political scandal. During the quarter, the central bank cut rates twice as inflation continued to decline. Estimates for 2017 and 2018 growth were revised upwards. The legislature successfully passed labor market reforms. Former President Lula was convicted on corruption charges, raising doubts about his eligibility to run in next year's election. Brazil's lower house voted to reject corruption charges against President Temer, increasing the odds that he will finish his term and be able to enact pension reform to help stabilize Brazil's deteriorating fiscal situation.

EM IG, HY and CEMBI



As of 30.09.2017	JPM CEMBI[7]
Q3 2017 performance in %	**2.63**
Credit spreads (bps)	277
Yield to worst in %	4.43
Duration in years	5.43

6) Source: J.P. Morgan. Date: 30.09.2017. 7) JPM Corporate Emerging Markets Bond Index Broad Diversified in USD. Date: 30.09.2017. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.**

In Focus

Low Duration European Covered Bond strategy

For those investors seeking, in the current low yield and even negative interest rate environment, an asset class that combines high safety and still positive yields, European covered bonds are worth a closer look. Being a very secure investment, covered bonds offer dual protection of investors asset; on the one side via full recourse to the issuer, and on the other side via a claim against a cover pool. This sets covered bonds on the same safety footing as sovereign debt.

Covered bonds may seem at first to be an easy investment option; however they are part of a highly inefficient market. This is a field where specialised and informed investors can grasp opportunities by being active outside the benchmark, leveraging on their deep knowledge and understanding of the asset class. Nordea has a dedicated team specialised in managing European and Danish covered bonds, accounting for more than EUR 39bn of assets under management. With a stable team of portfolio managers who have worked together for more than 10 years, the investment team has demonstrated strong historical alpha capabilities.

Current low yields create a problem for investors in the safe fixed-income spectrum: they are struggling to find a substitute for cash and government bonds which confers a sufficient guarantee of safety and still provides a positive yield. At the same time, although the ECB is currently one of the most dovish of the G-3 Central Banks, the European area sees a rising risk of a more hawkish tone. Under these market conditions, the Low Duration European Covered Bond solution represents an attractive investment, combining an asset class able to deliver attractive returns – without compromising quality – with limited interest rate risk, as the portfolio hedges the duration to approximately 1 year. Nordea will launch a dedicated fund pursuing the strategy in October 2017.

Nordea Fixed Income offering

The overview of our corporate credit offering ranked by performance

Nordea 1, SICAV	ISIN	Share class	Average weighted rating	Performance in Q3 2017 (in %)	Modified duration (years)	YTM (in %)
Global High Yield Bond Fund	LU0476539324	BP-USD	BB-	2.49	4.57[A]	5.09
Emerging Market Corporate Bond Fund	LU0634509870	BP-USD	BB+	2.28	5.97	4.82
Renminbi High Yield Bond Fund	LU1221952010	BP-CNH	BB[D]	2.05	3.5[C]	8.3[D]
European Financial Debt Fund	LU0772944145	BP-EUR	BBB	1.76	4.91[B]	3.39
US High Yield Bond Fund	LU0278531610	BP-USD	BB-	1.72	4.57[A]	5.17
International High Yield Bond Fund - USD Hedged	LU0826393653	BP-USD	BB-	1.38	4.90	5.88
European High Yield Bond Fund	LU0141799501	BP-EUR	BB	1.26	2.71[B]	3.97
North American High Yield Bond Fund	LU0826399429	BP-USD	BB-	1.21	4.66	5.84
European Corporate Bond Fund Plus	LU0533593298	BI-EUR	A-	1.04	5.05[B]	1.21
European Covered Bond Fund	LU0076315455	BP-EUR	A+	1.01	4.78	0.82
US Corporate Bond Fund	LU0458979746	BP-USD	BBB+	0.99	7.16[A]	3.30
European Cross Credit Fund	LU0733673288	BP-EUR	BB+	0.94	3.73[B]	2.59
Unconstrained Bond Fund	LU0975281527	BP-USD	BBB+	0.86	1.03[A]	3.07
Low Duration US High Yield Bond Fund	LU0602537069	BP-USD	BB	0.59	1.1[A]	3.82
Flexible Fixed Income Fund	LU0915365364	BP-EUR	AA-	-0.09	1.87	1.17

A) Effective Duration. Source: MacKay Shields. B) Modified Duration to Worst. Source: Nordea Investment Funds S.A. C) Source: Income Partners. D) Current Yield in CNH. Source: Income Partners Source (unless otherwise stated): Nordea Investment Funds S.A.. Date 30.09.2017. Initial and exit charges could affect the value of the performance. **Past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of shares can greatly fluctuate as a result of the sub-fund's investment policy and cannot be ensured.** If the currency of the respective share class differs from the currency of the country where the investor resides the represented performance might vary due to currency fluctuations.

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