Nordea

NEWSLETTER
Corporate Credit

First quarter 2017

Q1 2017 Market Review and Outlook

Strong start of the year

Main highlights

- **EU:** Decent economic growth in the European economies (despite a difficult political environment) and continued strong fundamentals of European companies.
- **U.S.:** After a strong January and February, "risk markets" reassessed the so-called Trump reflation trade. Furthermore, a number of US economists have noticed the difference between quantifiable data and survey-based indicators.
- **EM:** Underlying corporate and macro fundamentals remained supportive as investors continued to search globally for higher-yielding securities. U.S. Treasury yields and oil prices remained relatively steady, providing stability. Market technicals remained relatively balanced throughout the quarter.

Europe

Investment Grade by Nordea

The first quarter was a relatively uneventful one as volatility was low throughout the quarter, which in turn was a consequence of an overall stable environment on the political scene and in commodity markets. Furthermore, economic figures released during the quarter mostly pointed in a positive direction and the bulk of the annual results reported from companies were solid. Nevertheless, one risk continued to loom in the market, namely the upcoming French election which poses a threat to the stability in the Eurozone bloc, in case the right wing candidate (Marine Le Pen) wins. Ms Le Pen has repeatedly stated her opposition against the Euro and vowed to hold a referendum on France's membership if she wins the election.

For the time being, odds are against Ms Le Pen in the second round since she is not expected to win over the votes of the other candidates. All in all most factors were positive during the quarter leading to a fairly sanguine tone throughout Q1 2017 leading to spread tightening across the European Investment Grade market.

High Yield by Capital Four Asset Management A/S

The European High Yield spreads tightened by 16bps during the first quarter leading to a 1.89% return for the market. The good fundamental performance for European High Yield was initially accompanied by a solid demand for bonds as institutional investors' allocated money to European High Yield funds during the first two months, however outflows in March turned YTD flows negative. Nevertheless, we saw a strong supply of new deals in Q1 with more than 25bn EUR bonds pricing during the quarter with March accounting for roughly half of this (this compares to 8bn EUR of issuance in the same quarter last year). Despite a lot of this volume was due to refinancing, we still saw decent net supply. The quality of the new deals coming to market continues to be adequate and external research suggest that average leverage multiples decreased from recent quarters also when just looking at the single-B segment.

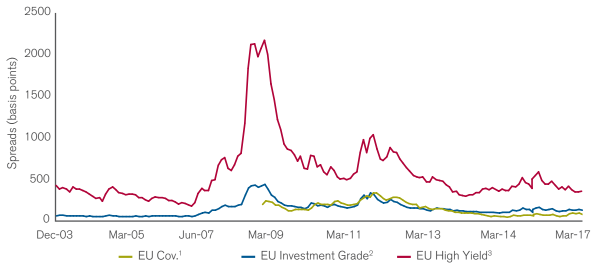
As was the case in Q4, uncertainty about future interest rate levels continued to be a source of volatility, however more so in the US than in Europe as the US Fed decided to hike interest rates in March for the second time in three months. Despite some concerns of ECB tapering, German government bond yields were only slightly up during the quarter but with significant intra-quarter movements. The European High Yield market proved resilient during March in the wake of a volatile US High Yield Market. The US High Yield market was impacted by large outflows, declining oil prices and concerns about interest rates and traded down almost 2% at mid-month before recovering again ending the month down at negative 0.2%

In Q1, the returns of the different benchmark rating categories were: BB 2.01%, B 1.41% and the CCC-rated bonds returned 3.7%. The best performing sectors within the benchmark were insurance, energy and transportation while the worst performing sectors were consumer goods, automotive and technology & electronics.

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 strong fundamentals of European companies as well as a bias for high quality and modest leverage in the new issue market. Default remains very low and estimates from sell-side strategist continue to indicate very low default rates going forward. The European High Yield spread-to-worst widened to 373bps in March. If we assume a default rate

*Investing for their own account – according to MiFID definition of 2.1% for the coming 12 months and a recovery rate of 40%, European High Yield bonds would generate an excess return of 247bps versus government bonds if the high yield spread stays unchanged at 373bps.

EU Covered vs. Investment Grade vs. High Yield market



As of 31.03.2017	EU Cov.[1]	EU IG[2]	EU HY[3]
Q1 2017 performance in %	0.03	0.26	1.92
Credit spreads (bps)	81	120	373
Yield to worst in %	0.42	0.93	3.43
Duration in years	5.00	5.37	3.49

1) iBoxx EUR Covered Bond Index Source: Analytics. Date: 31.03.2017.
2) Merrill Lynch EMU Corporate Bonds Index. Source Bloomberg (ER00 ticker). Date: 31.03.2017.
3) Merrill Lynch European Currency High Yield Constrained – Total Return Index (100% EUR Hedged). Source Bloomberg (HPC0 ticker). Date: 31.03.2017.

The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.

U.S.

Investment Grade & High Yield by MacKay Shields LLC

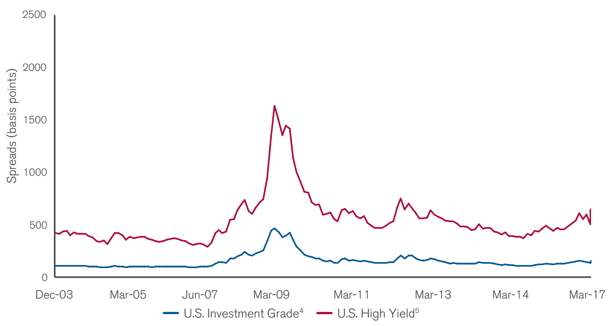
After a strong January and February, "risk markets" reassessed the so-called Trump reflation trade later in the quarter and after the failure of the administration to garner enough Republican support in the House of Representatives to repeal and replace Obamacare. This was a key tenet of the president's campaign along with tax cuts, deregulation, and infrastructure spending. Initially, capital markets assigned a high probability to the implementation of stimulative policies by the new administration; however, the timing and likelihood of such policy stimulus is now open to debate. Furthermore, a number of US economists have cited the difference between quantifiable data and survey-based indicators. For instance, small business optimism is near its 43 year high while consumer sentiment has reached levels last seen in 2000. However, hard data statistics such as retail sales and capital spending are more muted. Nevertheless, US labor conditions remain tight with unemployment at 4.7%, and the domestic economy continues to expand. The Federal Open Market Committee (FOMC) raised the Fed funds target rate in March to 0.75% as was widely expected, and the Committee signaled that three more rate hikes are likely in 2017. The US Treasury curve flattened as front-end yields rose while five- and ten-year Treasury yields declined. The yield on the two-year Treasury closed 7 basis points higher at 1.25%; the five-year at 1.92% (almost unchanged); and the ten-year bond closed 6 basis points lower at 2.39%. Britain formally invoked Article 50 of the Lisbon Treaty setting the two-year Brexit process in motion; this combined with higher domestic inflation reports pushed the yield on ten-year gilts to 1.30%. Three-month LIBOR rose to 1.15% after closing the previous quarter at 1.00%.

During the quarter, investment grade corporate spreads tightened 5 bps to 118 bps, according to statistics provided by Bloomberg Barclays. Strong demand from Asia and lower dealer inventories were cited as contributors to a positive backdrop for US credit. At an industry level, financials, including banking and insurance, and healthcare have performed very well, while lower quality BBB rated credits have bested the returns of higher quality single-A and double-A rated names, on average. M&A activity receded during the quarter, but still remains relatively high due to tight spreads and low volatility. Broadly supportive economic data and improved earnings growth should continue to attract yield-seeking investors to the asset class, notwithstanding any geopolitical or policy risks. The US Treasury yield curve flattened during the quarter as the Federal Reserve continued on its slow path towards a re-normalization of policy rates.

US high yield (HY) posted significant gains for the quarter even after a tumultuous March. According to JP Morgan, US HY bond issuance reached $98.7 billion during the period with approximately 67% of the total represented by refinancing activity. Par-weighted HY defaults over the last twelve months (LTM) dropped largely due to the rolling off of early 2016 commodity sector inflated defaults. This trend will continue as the high default volume of April 2016 rolls off the annual tally. JP Morgan pegged the HY default rate – including distressed exchanges – down to 2.51% by the end of the period. LTM recoveries of 36.7% remain slightly below historical averages but are improving. HY mutual fund outflows were $7.4 billion in March following -$194 million in February and -$152 million in January. ETFs experienced $1.9 billion of outflows over the three month timespan. The heavy outflows of March resulted in liquid high yield names underperforming less liquid names which did not experience the same selling pressure and, thus, may not have as accurate marks. The price performance of more liquid names tend to bear the brunt of large outflows and, conversely, perform better in periods of large inflows. Such price movements relative to lightly traded or illiquid segments of the HY market tend to be transitory. During the first quarter the transportation, telecommunications, and healthcare sectors were the strongest performers in the widely watched Bank of America/Merrill Lynch US High Yield Index. Although consumer goods, automotive, and energy posted positive returns, they lagged the benchmark. Retail posted negative returns. Lower-rated bonds tended to outperform higher rated. Although the credit fundamentals of the non-investment grade market are broadly sound, we are concerned that low return on capital, an uptick in leverage, and rapid technological changes have led to an increase in idiosyncratic risk.

We believe there will be continued upward pressure on short-term US interest rates in 2017 as the Federal Reserve tightens monetary conditions and the new administration embarks on looser fiscal policies. The fundamental economic backdrop in the US has been durable; consumption is being supported by a healthy consumer enjoying wage gains from a tighter labor market and an increase in wealth from a burgeoning housing market. President Trump's fiscal platform calls for an increase in spending, especially on infrastructure, and lower taxes for households and businesses. While tax cuts should be stimulative for the US economy in the short-to-medium term, some of the other proposals may not have the same impact, in our view. In particular, protectionist trade policies would likely curtail global growth and incite trade wars. We do believe credit spreads could tighten modestly given our tempered outlook for corporate earnings and high levels of idiosyncratic risk. Valuations generally remain fair across the credit sectors but greater vigilance is required as we navigate the late stages of the current economic cycle.

U.S. Investment Grade vs. High Yield market



As of 31.03.2017	U.S. IG 4	U.S. HY5
Q1 2017 performance in %	1.30	2.71
Credit spreads (bps)	118	392
Yield to worst in %	3.50	5.88
Duration in years	7.00	4.21

4) Barclays Capital US Credit Index. Source: © 2017 Barclays Bank PLC. All rights reserved. Member SIPC. Date 31.03.2017.
5) Merrill Lynch US High Yield Master II – Total Return Index. Source Bloomberg (H0A0 ticker). Date: 31.03.2017.

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 strong total returns of 2.97% in the first 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. U.S. Treasury yields and oil prices remained relatively steady, providing stability. Market technicals remained relatively balanced throughout the quarter. Consistently strong inflows this quarter provided ample support for an uptick in new supply.

The benchmark's yield to maturity decreased from 5.44% to 5.22%, driven by spread tightening, as U.S. Treasury yields modestly increased. Corporate credit spreads have moved toward the tightest levels seen 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 negative correction in valuations. 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; industrial; and oil and gas sectors. Latin American and African corporates produced the strongest returns, with all regions contributing to gains.

Emerging markets corporate bond gross issuance for the quarter was $114 billion, a record for quarterly issuance, but modest when accounting for amortizations and debt buybacks. Net issuance was roughly $33 billion. 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 is $315 billion, with some risk to the upside given the first quarter's elevated activity.

The European Central Bank held rates steady throughout the quarter ahead of a reduction in monthly purchases set to begin in April. The Bank of Japan maintained its policy of keeping the 10-year government bond yield near 0% but reported an uptick in growth and inflation. In a widely anticipated move, the U.S. Federal Reserve raised its fed funds target rate and reiterated its plans for more rate increases in 2017.

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 4.5% and 4.8% 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.

Brazil continued to enact reforms as it addresses economic challenges. Foreign investment has improved and balance of payments has strengthened. During the quarter, the central bank cut rates twice as inflation continued to decline and growth remained stalled. Dovish statements from the central bank indicated additional cuts were likely. Debate on proposed pension reforms is set to begin in April, as the government seeks to improve its long-term debt profile. The currency has remained stable as the central bank unwinds its FX swap book. Forecasts show Brazil exiting recession this year.

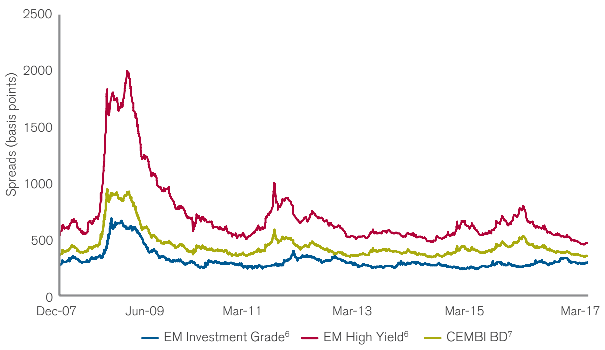
Russia produced small GDP growth in the fourth quarter of 2016. An uptick in growth for 2017 is forecast as signs of domestic consumption return. Food prices are predicted to fall due to a successful harvest, leading to reduced inflation and potential for more interest rate cuts.

In Argentina, growth has also improved. The country reported positive GDP growth during the second half of 2016. As investment in the energy sector kicks in and efficiencies in agriculture continue, growth is expected to pick up.

Signs of economic stability in China helped support investor appetite for risk. Industrial production picked up, the yuan remained relatively steady versus the U.S. dollar, and FX reserve losses stabilized. China announced a 6.5% economic growth target for 2017 at its annual National People's Congress in March, slightly lower than last year's 6.7% expansion. The NPC kept annual targets for the budget deficit, inflation, and other metrics largely unchanged from 2016, reflecting China's focus on containing risks and maintaining stability ahead of a leadership change this fall.

Mexico raised rates twice during the quarter to tame inflation that had climbed above the central bank's target due to increased fuel prices and a decline in the peso. A softened tone from the U.S. regarding trade negotiations along with the series of rate hikes helped the currency largely recover from recent losses.

EM IG, HY and CEMBI



As of 31.03.2017	JPM CEMBI [7]
Q1 2017 performance in %	2.97
Credit spreads (bps)	295
Yield to worst in %	4.73
Duration in years	5.31

6) Source: J.P. Morgan. Date: 31.03.2017.
7) JPM Corporate Emerging Markets Bond Index Broad Diversified in USD. Date: 31.03.2017.

The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.

Funds in Focus

The Nordea 1 – Flexible Fixed Income Fund
(ISIN LU0915365364, BP-EUR)

The Nordea 1 – Unconstrained Bond Fund – USD Hedged
(ISIN LU0975281527, BP-USD)

While investors continue to look for yields and expectations about increasing rates dominate markets, **many unconstrained fixed income managers have loaded their portfolios with high yielding credit** (HY) and/or Emerging Market debt (EMD) while discarding duration from high quality government bonds. This almost aligned positioning across the unconstrained fixed income universe **presents a risk to portfolios that lack solutions able to diversify if risky assets** were to struggle.

In this environment, the Nordea 1 – Flexible Fixed Income Fund (FFIF) offers investors **a good alternative to balance out the sizeable amount of credit risk** embedded in their portfolios. The portfolio management team's focus on diversification translates **into higher levels of duration and a relatively smaller allocation to credit,** compared to what most peers have today.

However, for those investors who seek more credit sensitivity product, with a low duration, the Nordea 1 – Unconstrained Bond Fund – USD Hedge can also be an interesting investment vehicle.

Diversification cannot be timed and it **matters** within portfolios as much as it does **across managers' styles.** All in all, it might well be worth considering to put at least one egg in a different basket.

Nordea Fixed Income offering

The overview of our corporate credit offering ranked by performance

Sub-fund name of Nordea 1, SICAV	ISIN code	Share class	Average weighted rating	Performance in Q1 2017 (in %)	Modified duration (years)	YTM (in %)
Renminbi High Yield Bond Fund	LU1221952010	BP-CNH	BB [D]	4.27	3.20 [C]	7.70 [D]
European Financial Debt Fund	LU0772944145	BP-EUR	BBB	3.50	5.35 [B]	3.95
Emerging Market Corporate Bond Fund	LU0634509870	BP-USD	BB+	3.02	5.19	4.93
North American High Yield Bond Fund	LU0826399429	BP-USD	BB–	2.60	4.84	6.29
International High Yield Bond Fund – USD Hedged	LU0826393653	BP-USD	BB–	2.57	4.58	5.83
Global High Yield Bond Fund	LU0476539324	BP-USD	BB–	2.38	4.84 [A]	5.60
US High Yield Bond Fund	LU0278531610	BP-USD	BB–	2.19	4.87 [A]	5.85
European High Yield Bond Fund	LU0141799501	BP-EUR	BB	2.02	2.81 [B]	4.45
US Corporate Bond Fund	LU0458979746	BP-USD	BBB+	1.39	6.98 [A]	3.50
Unconstrained Bond Fund	LU0975281527	BP-USD	BBB+	1.02	0.78 [A]	3.45
Flexible Fixed Income Fund	LU0915365364	BP-EUR	A+	0.81	5.05	2.08
Low Duration US High Yield Bond Fund	LU0602537069	BP-USD	BB	0.77	1.31 [A]	3.95
European Cross Credit Fund	LU0733673288	BP-EUR	BB+	0.66	3.32 [B]	2.62
European Corporate Bond Fund Plus	LU0533593298	BI-EUR	A–	0.34	5.22 [B]	1.26
European Covered Bond Fund	LU0076315455	BP-EUR	AA–	0.24	4.89	0.73

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 31.03.2017. 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 base currency of the respective sub-fund differs from the currency of the country where the investor resides the represented performance might vary due to currency fluctuations.

NL_CC_N1_eng_INT