For professional investors only*

CORPORATE CREDIT – QUARTERLY NEWSLETTER

First quarter 2019

Market Review and Outlook

Uncertainties remain as we enter 2019

Main highlights

- **EU:** A challenging quarter due to growing macro concerns and the ECB reducing its monetary stimulus.
- **US:** Flight-to-quality with Treasuries rallying and High Yield underperforming.
- **EM:** Showing resilience in a deteriorating macro environment. Political developments in Brazil and Mexico were well received by the market.

Europe

Investment Grade by Nordea

The overall market sentiment has turned negative. It is hard to pin point one single explanatory factor behind the negative investor sentiment. As we enter 2019 the uncertainties remain largely unchanged and one can list quite a few unsolved issues. This includes Italy, Brexit, escalating tradewar rhetoric, deteriorating macro backdrop and reduction of monetary easing.

Even the covered bond market has been challenged: it was in fact the worst year for the asset class since 2011, with a spread widening of 22 bps. From a technical perspective, there has been pressure on spreads from a larger than expected supply on the primary market. At the same time, the ECB decided to gradually cut its order size. The supply of covered bonds will again play an important role in the spread development in 2019. The consensus between analysts is that €130 – €1501bn of covered bonds will be issued in 2019. That means a relatively high net supply and a small upward pressure on spreads. On the demand side, it is expected that the ECB will end net purchases in the Asset Purchase Program (APP) from January 2019 which is likely to put further negative pressure on spreads. However, the ECB has indicated that they will reinvest principal payments, and it is expected that it will remain in the same asset classes as the maturing bonds. Additionally, there are indications from bank treasuries that the spread in core covered bonds versus the underlying spread now has reached a level where they are ready to increase their exposure in covered bonds. This might offset the gap that the ECB leaves.

For the credit markets, technical support remained a negative driver for the quarter as the imbalance between supply and demand for corporate bonds continued. The technical imbalance means that minor reporting disappointments are likely to be punished more consequently in today's market than was the case just a few months ago. Idiosyncratic risks are expected to remain high.

High Yield by Capital Four Asset Management A/S

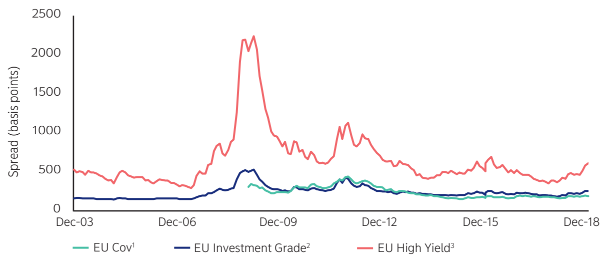
European High Yield spreads widened by 151bps to 520bps during the fourth quarter of the year. The European High Yield Market had a negative return for the quarter as the asset class was not insulated from several growing concerns related to geopolitics, supportiveness of central banks, energy prices and late cycle slowdown in the global economy. Europe specific issues such as Italy and Brexit negotiations also drove negative market sentiment and in addition we also saw idiosyncratic risk to a large extent dragging returns down with several single names selling off. Avoiding deep negative tail risk is thus becoming increasingly important.

There was a general flight-to-quality and the BB-rated part of the European High Yield market outperformed the lower rated buckets. In Q4, the returns of the different benchmark rating categories were: BB –2.6%, B –5.5% and the CCC-rated bonds returned –9.1%. In general, more cyclical sectors underperformed more defensive sectors due to the general risk off sentiment and late cycle positioning as well as business model challenges within specific areas (e.g. brick and mortar retail companies and paper pulp producers).

*investing for their own account – according to MiFID definition

Despite the increased volatility we saw in 2018, default rates remain at very low levels (below 1%) that are well below the long-term average (around 3%). Fundamentals continue to look healthy with high interest rate cover ratios and leverage remaining at overall sound levels.

EU Covered vs. Investment Grade vs. High Yield market



As of 31.12.2018	EU Cov.[1]	EU IG[2]	EU HY[3]
Q4 2018 performance in %	**0.44**	**−0.59**	**−3.56**
Credit spreads (bps)	87	154	523
Yield to worst in %	0.59	1.29	5.20
Duration in years	4.65	5.05	4.03

Date: 31.12.2018. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.** 1) iBoxx EUR Covered Bond Index. Source: Analytics. Date: 31.12.2018. 2) Merrill Lynch EMU Corporate Bonds Index. Source: Bloomberg (ER00 ticker). Date: 31.12.2018. 3) Merrill Lynch European Currency High Yield Constrained – Total Return Index (100% EUR Hedged). Source: Bloomberg (HPC0 ticker).

US

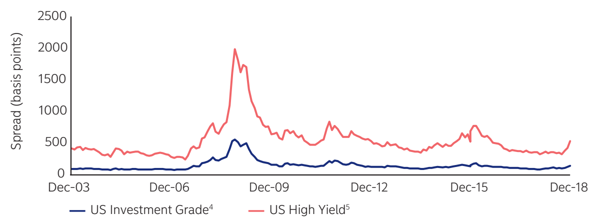
Investment Grade & High Yield by MacKay Shields LLC

US Treasuries rallied significantly in the fourth quarter while both credit and equity investments sold off on fears of weaker global growth in China, Japan and the European Union, restrictive US Fed policy and the US administration's public criticism of the Fed, trade wars with China, Brexit negotiation uncertainty, mid-term elections and the potential for a government shutdown. The benchmark 10-year Treasury rate fell nearly 60 bps from its mid-November high to close the year at 2.65%. More disconcerting was the inversion of the front-end of the yield curve during the quarter, as measured between 2-year and 5-year maturities. Although the inversion appeared to be driven by strong technical considerations associated with a flight-to-quality, it is worth noting that an inverted curve has been historically a strong indicator of an economic slowdown.

Investment grade corporate spreads, as measured by the Bloomberg Barclays US Corporate Index widened 48 bps. Much of the spread widening can be attributed to poor market technicals, including reduced liquidity that amplified price swings. Additionally, heavy supply, headwinds from FX hedging costs from foreign buyers and reduced demand also played a role. In our view, idiosyncratic risk is much more prevalent in the market today, as we have seen with names such as General Electric and the US auto manufacturers. Lower quality BBB rated credits underperformed higher quality credits and longer maturities underperformed shorter maturities. Non-cyclical sectors also outperformed.

US high yield spreads widened by 205 bps during the fourth quarter. During October, spreads reached a tight for the current cycle at 316 bps over Treasuries, but subsequently widened during each month of the quarter. Spreads across ratings segments moved largely as expected during a significant risk off quarter with BBs widening by 147 bps while Bs and CCCs widened by 226 bps and 430 bps respectively. From a performance standpoint, higher quality credit was the clear outperformer with CCCs and Distressed lagging by a meaningful margin. Shorter dated bonds outperformed as well. For the quarter, performance was uniformly negative across all sectors, but only one sector meaningfully underperformed the broader market: Energy. Energy lagged the broader market by over 500 bps as the price of WTI oil declined by approximately 40% during the quarter due to continued production growth from the shale plays in the US which upset the commodity's demand/supply equilibrium. Better performing sectors for the quarter were generally less cyclical in nature with a higher quality issuer base. High yield issuance slowed dramatically during the fourth quarter. Importantly, spreads during the current cycle have exceeded 875 bps twice (during October 2011 and February 2016) and in both instances when spreads reached those levels, new issues were able to come to market suggesting that seasonality played a role in the lack of issuance.

US Investment Grade vs. High Yield market



As of 31.12.2018	US IG[4]	US HY[5]
Q4 2018 performance in %	**−0.22**	**−4.67**
Credit spreads (bps)	143	523
Yield to worst in %	4.09	7.95
Duration in years	6.87	4.19

Date: 31.12.2018. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.** 4) Bloomberg Barclays Capital US Credit Index. Source: © 2018 Barclays Bank PLC. All rights reserved. Member SIPC. Date 31.12.2018. 5) Merrill Lynch US High Yield Master II – Total Return Index. Source: Bloomberg (H0A0 ticker).

Emerging Markets

Emerging Markets Corporates by T. Rowe Price International Ltd.

Emerging Markets (EM) corporate debt produced marginally negative total returns in the fourth quarter. Underlying corporate and macro fundamentals remained supportive in EM. Market technicals were challenging, reduced new supply was met with outflows from EM.

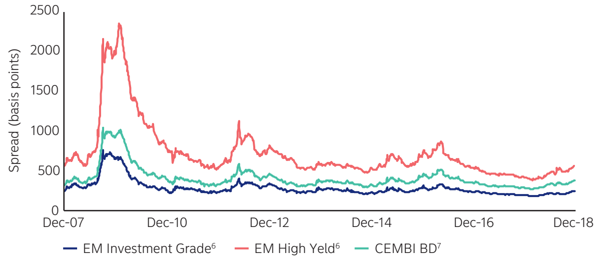
EM corporate bonds have been resilient relative to other risk assets, such as US high yield, EM sovereign debt, EM local currency bonds, and EM equity, in the recent sell-off as well as other historic market corrections. This is due in part to the asset class's higher credit quality, US dollar denomination, and bias toward the more defensive Asia region.

Brazil elected center right Jair Bolsonaro as president, while Mexico elected leftist Andres Manuel Lopez Obrador (AMLO). Bolsonaro's economic agenda, which includes pension reforms, is generally seen as market-positive. Mexican assets were volatile as investors grew wary of (AMLO)'s policies following a referendum that led to the cancelation of the new Mexico City airport. The central bank raised rates twice in an effort to support the peso amid investors' concerns. Later, AMLO's administration unveiled its 2019 budget that was well received by the market. The government's revised tender offer for bonds issued to fund the canceled Mexico City Airport project was successful.

EM corporate bond gross issuance for the quarter was around $75 billion. Asian issuers accounted for the majority of new quarterly supply. New issues from investment-grade companies continue to outpace those from high yield.

Going into 2019, we are cautiously optimistic given supportive EM fundamentals and the high carry profile of the asset class. That said, EM corporate debt is not insulated from exogenous risk factors, highlighting the importance of bottom-up credit selection.

EM IG, HY and CEMBI



As of 31.12.2018	JPM CEMBI[7]
Q4 2018 performance in %	**−0.04**
Credit spreads (bps)	371
Yield to worst in %	6.14
Duration in years	5.16

Date: 31.12.2018. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.** 6) Source: J.P. Morgan. Date: 31.12.2018. 7) JPM Corporate Emerging Markets Bond Index Broad Diversified in USD.

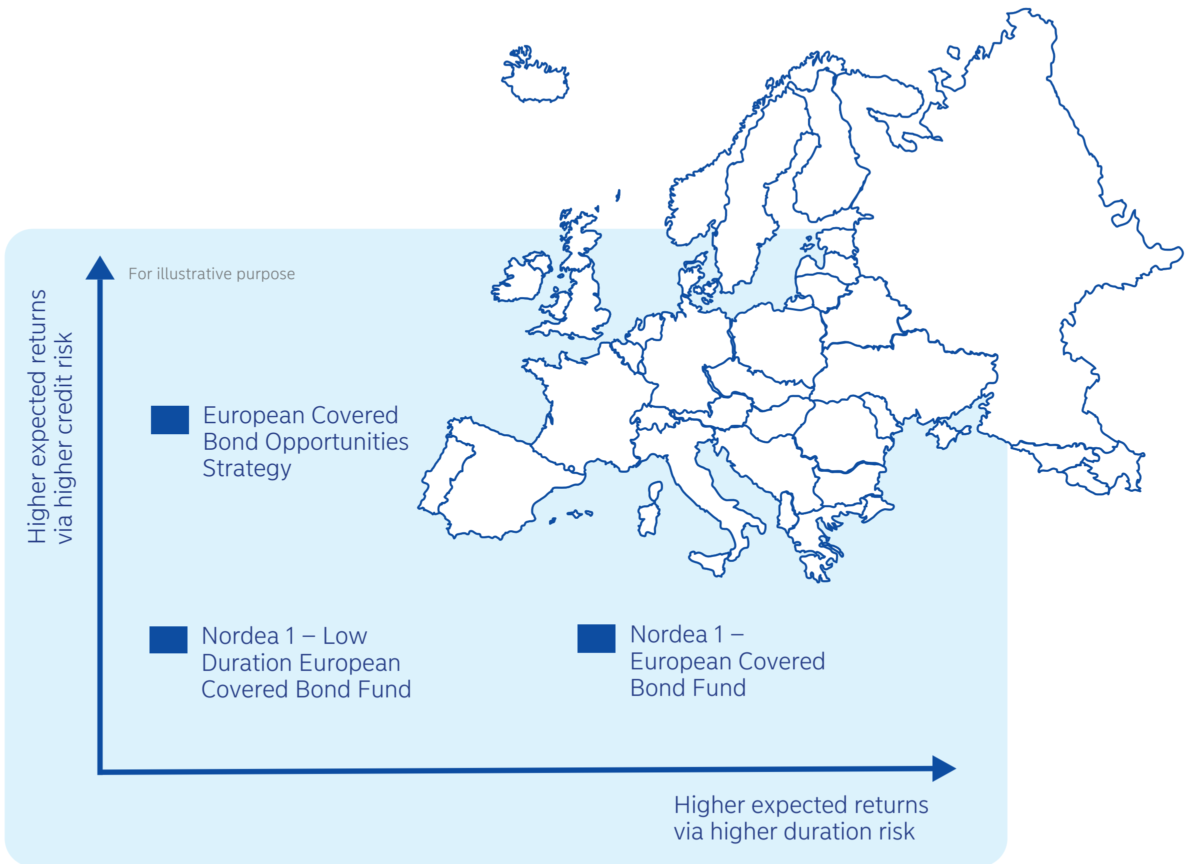
In Focus

No place to hide? Think European covered bonds

Within a low yield – and choppy! – environment, investors have a hard time finding an attractive and low risk fixed income solution. The answer may simply be found in the European covered bond market. When 2018 was a difficult year for most investors... Nordea's covered bond products have been a one-of-a-k ive. The resilience of the asset class combined with the ability of Nordea's investment team to navigate this inefficient market has played a major role in the strong performance of those solutions, when most safe solutions did struggle to limit losses.

Nordea's expertise is at your reach with one strategy... yet three different exposures to the market. First, the Nordea 1 – European Covered Bond Fund is our main solution with a similar duration as the market (around 4–5 years): it has been delivering a convincing track of alpha generation since its inception in 2012, and now represents more than EUR 2.4 bn in AuM. For investors who do not want a significant duration exposure, we launched a second solution in October 2017 for which we already gathered more than EUR 1.4 bn of assets: the Nordea 1 – Low Duration European Covered Bond Fund, with a lower interest rate risk (around 1 year duration).

Following these successes, we are now launching a new strategy, the European Covered Bond Opportunities Strategy, which aims at leveraging on the investment expertise of the investment team. The strategy hedges the duration to around 1 year, similar as the Nordea 1 – Low Duration European Covered Bond Fund, however it expands further the credit exposure using leverage and derivatives. To sum it up, a solution that you should not shy away to follow closely: an innovative way to aim at higher returns through a higher credit exposure to covered bond spread.



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 Q4 2018 (in %)[F]	Modified duration (years)	YTM (in %)
US Corporate Bond Fund	LU0458979746	BP-USD	BBB+	0.41	6.58[C]	4.14
European Covered Bond Fund	LU0076315455	BP-EUR	A+	0.24	5.13[D]	0.94
Low Duration European Covered Bond Fund	LU1694212348	BP-EUR	AA–	–0.36	1.82[D]	0.70
Flexible Fixed Income Fund	LU0915365364	BP-EUR	A[A]	–0.58	4.18[A]	2.26[A]
Emerging Market Corporate Bond Fund	LU0634509870	BP-USD	BB+	–0.62	5.39	6.54
European Corporate Bond Fund Plus	LU0533593298	BI-EUR	A–	–0.87	5.26	1.53
Renminbi Bond Fund[E]	LU1221952010	BP-CNH	BB[B]	–1.03	2.90[B]	7.5[B]
Low Duration US High Yield Bond Fund	LU0602537069	BP-USD	BB–	–1.16	1.86[C]	5.10
Unconstrained Bond Fund – USD Hedged	LU0975281527	BP-USD	BBB+	–1.90	0.65[C]	4.25
European Cross Credit Fund	LU0733673288	BP-EUR	BB+	–2.90	3.32	3.59
European Financial Debt Fund	LU0772944145	BP-EUR	BBB	–3.14	4.32	3.95
European High Yield Bond Fund	LU0141799501	BP-EUR	BB–	–3.90	4.07	5.24
US High Yield Bond Fund	LU0278531610	BP-USD	BB–	–4.22	4.27[C]	6.84
Global High Yield Bond Fund	LU0476539324	BP-USD	BB	–4.41	4.27[C]	6.01
International High Yield Bond Fund – USD Hedged	LU0826393653	BP-USD	BB–	–4.53	4.54	7.77
North American High Yield Bond Fund	LU0826399429	BP-USD	BB–	–4.93	4.47	8.12

A) Source: Nordea Investment Funds S.A., Multi Asset Team B) Source: Income Partners C) Effective Duration, Source: MacKay Shields D) Effective Duration. E) With effect as of 19.11.2018 the investment policy of the sub-fund was modified. The performance figures shown prior to that date were achieved under circumstances that no longer apply. With effect as of 19.11.2018 the sub-fund is renamed from Nordea 1 – Renminbi High Yield Bond Fund to Nordea 1 – Renminbi Bond Fund. F) **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.**