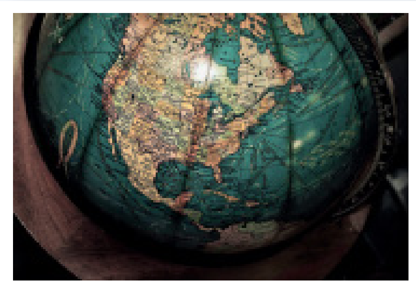
Quarterly Newsletter
Corporate Credit



Fourth quarter 2019

Market Review and Outlook
Central banks to the rescue!

Main highlights

- **EU:** The ECB backs the credit market once again with further monetary easing. However, volatility is on the rise as macroeconomic concerns remain.
- **US:** The Fed turns back to easing mode, leading to strong returns for longer duration, higher quality credit. The frenzied tariff war between the US and China continues.
- **EM:** EM corporate debt benefits from the persistent global bid for yield. Argentine assets came under pressure as opposition candidate Fernandez did unexpectedly well in the presidential primary election.

Europe

Investment Grade & Covered Bonds by Nordea

The quarter started with a rally in European Investment Grade corporate bond spreads on the back of the European Central Bank (ECB) delivering further monetary easing including a rate cut, the introduction of the so-called tiering system, the restart of the QE purchasing program, and the easing of some TLTRO III conditions. With European corporate fundamentals showing that companies are reluctant to borrow, it is questionable though that QE is the right solution for the Eurozone's problems. That notwithstanding, the prospect has allowed the European Investment Grade market to be "risk-on" and to mostly overlook issues such as Brexit and weak earnings.

However, volatility in credit markets increased in August, when investors' attention was focused on weak earnings growth reported by European companies, in particular for those in cyclical sectors.

In September we saw a continuation of poor manufacturing numbers which, over the last several months, have weighted negatively on the fundamentals for some of the cyclical names. This, together with heavy supply, resulted in European Investment Grade corporate bond spreads to widen back to the level in June (around 112bps). It is worth noting though that services and consumer sentiment is still holding up.

The covered bond market has moved sideways over the quarter. The iBoxx EUR Covered Bond Index saw its spread vs. swap widening by 0.5bps, which means a rather stable development since May. UK covered bonds have been the largest underperformer due to Brexit-risk, but Scandinavia, core Europe and Canada have also widened a bit. The EUR swap curve has decreased and flattened with the 5Y spot tightening by 18bps and the 30Y spot by 50bps in Q3 2019. This contributed positively to overall performance in the covered bond market.

Regarding covered bond issuance, we have seen an extremely active first half (and especially the first quarter) of the year. It seems that a lot of issuers have met their funding target already. Hence, issuance is slowing.

High Yield by Capital Four Asset Management A/S

European High Yield spreads widened by 1bps to 392bps during Q3. Returns were primarily driven by decreasing rates, which led to an improvement in the risk sentiment and strong inflow to the market in July. The market experienced a short setback in the beginning of August, as macroeconomic concerns, primarily related to trade wars, grew. This was, however, quickly offset by the continued decreasing rates towards the end of the quarter.

As expected, the activity in the primary market was limited in August due to the summer holiday period. The market activity picked up significantly in September, as the volume of new deals in the European high yield market exceeded EUR 8bn, making it the second most active month of 2019.

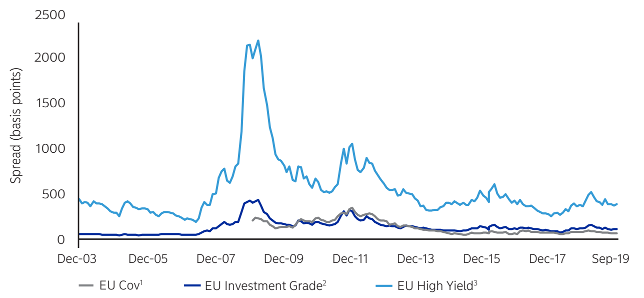
*investing for their own account - according to MiFID definition

In general, the more cyclical sectors outperformed the stable sectors. The best performing sectors were Insurance, Energy and Banking, while the worst performing sectors were Transportation, Services and Healthcare.

Default rates in 2019 remain at very low levels (below 1%), which are well below the long-term average (around 3%). Fundamentals within the European high yield still look healthy with high interest rate cover ratios and leverage remaining at overall healthy levels. We expect default rates to be in the 1.5% to 3.5% range in 2019, with the lower end of the range being most likely given the current low levels.

The European High Yield spread-to-worst widened to 392bps in September. If we assume a default rate of 1.5% to 3.5% for the coming 12 months and a recovery rate of 40%, European High Yield bonds would generate an excess return of 302bps to 182bps versus government bonds if the high yield spread stays unchanged at 392bps.

EU Covered vs. Investment Grade vs. High Yield market



As of 30.09.2019	EU Cov.[1]	EU IG[2]	EU HY[3]
Q3 2019 performance in %	1.18	1.33	1.31
Credit spreads (bps)	59	112	385
Yield to worst in %	−0.21	0.40	3.31
Duration in years	4.79	5.2	3.1

Date: 30.09.2019. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of your investment can go up and down, and you could lose some or all of your invested money.** 1) iBoxx EUR Covered Bond Index. Source: Nordea Investment Funds S.A., Nordea Analytics and Markit. Date: 30.09.2019. 2) Merrill Lynch EMU Corporate Bonds Index. Source: Bloomberg (ER00 ticker). Date: 30.09.2019. 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

The US Federal Reserve (Fed) Board announced a 25 bps cut on the 31st of July, bringing the Fed funds rate target to the 2.00 – 2.25% range, and followed with another 25 bps rate cut on September 18th, bringing the Fed funds rate target to the 1.75 – 2.00% range. Despite the Fed funds rate cuts, the yield curve remains inverted.

According to the monthly jobs reports, released by the Bureau of Labor Statistics, US labor markets added 430,000 nonfarm payroll jobs to the economy in the third quarter of 2019, showing job growth but at a continuingly slowing rate. US manufacturing PMI rose slightly in September, but quarterly measurements were still at lows not seen since 2009, according to IHS Markit.

The frenzied tariff war between the US and China continued throughout the quarter. Unproductive negotiations kicked off the quarter in July, tariffs increased on both sides in August, and in September there were reports that the US would target Chinese companies on US exchanges. Despite the rhetoric, representatives from both economies expect to continue negotiations in October. Moreover, with increased tariffs still in place, prolonged trade tensions will continue to be a major factor affecting global growth.

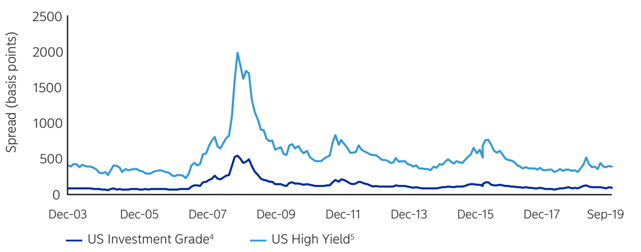
Investment grade corporate spreads, as measured by the Bloomberg Barclays US Corporate Index, remained flat for the quarter. All major sectors performed positively during the full quarter, led by utility and telecommunications sectors. Energy and financial institutions lagged the most for the quarter, albeit still performing positively.

US high yield spreads tightened by 5 bps in the third quarter to 402 bps over Treasuries, according to ICE BofA Merrill Lynch. In the context of another strong quarter for fixed income assets as treasuries continued to rally, there was significant dispersion in returns across the risk spectrum, with higher quality credit meaningfully outperforming lower quality credit. BB rated bonds were up by 2.06% and distressed debt was down by −11.26%.

The US housing market has been one recent bright spot, as the latest data now shows clear signs of strengthening home sales and housing starts. This improvement likely reflects the sustained decline in mortgage rates, rising household incomes and strong consumer balance sheets in the aggregate. But a key risk for this sector, as well as for spending more broadly, is that recent declines in household confidence eventually lead to a more cautious stance in household budgeting decisions.

Against the backdrop of moderating economic activity, downside risks from trade policy and weak global growth, and a lack of inflation pressure, we continue to expect further rate cuts from the Federal Open Market Committee. By the middle of next year, we would expect the top of the range for the federal funds rate to be no higher than 1.5 percent, 50 basis points lower than its current level.

US Investment Grade vs. High Yield market



As of 30.09.2019	US IG[4]	US HY[5]
Q3 2019 performance in %	2.98	1.26
Credit spreads (bps)	109	402
Yield to worst in %	2.85	6.36
Duration in years	7.59	3.43

Date: 30.09.2019. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of your investment can go up and down, and you could lose some or all of your invested money.** 4) Bloomberg Barclays Capital US Credit Index. Source: © 2019 Barclays Bank PLC. All rights reserved. Member SIPC. Date 30.09.2019. 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.

EM corporate spreads modestly widened from last quarter due to concerns about slowing global growth and weakness in some high yield markets. Rate cuts from several central banks and expectations for additional easing drove yields down though and tepid growth forecasts contained longer-term yields. Longer-duration, investment grade issues significantly outperformed high yield securities, though both generated positive returns. Nearly all corporate sectors advanced for the quarter as U.S. Treasury yields fell notably, led by gains in the transportation; technology, media, and telecommunications; infrastructure; and industrial sectors. Only the consumer sector generated negative returns. All regions were positive, led by corporates from Emerging Europe, the Middle East, and Africa.

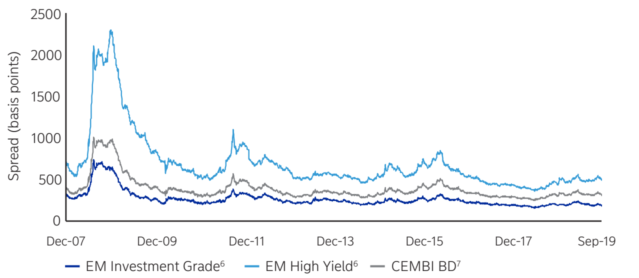
Not only the Fed and the ECB turned back to easing mode. The People's Bank of China reduced reserve requirements for banks, aiming to boost liquidity and several EM central banks, including Brazil, Russia, Mexico, Ukraine, Chile, Indonesia, South Africa, Turkey, and Egypt cut rates as well to spur growth.

In Turkey, President Recep Tayyip Erdogan removed central bank governor Cetinkaya and replaced him with Murat Uysal. Fitch downgraded Turkey's credit rating, citing concerns about the central bank's lack of independence. Shortly after Uysal took office, the Turkish central bank cut rates more than expected. Following a low inflation print for August, the central bank cut rates a second time to encourage growth.

In Argentina, opposition candidate Alberto Fernandez's unexpectedly strong performance over incumbent President Mauricio Macri in the presidential primary election led to a sharp selloff in Argentine assets. The government announced it will delay repayments on short-term local notes, leading S&P and Fitch to declare Argentina in selective default, adding to the negative sentiment. As a result, Argentina implemented capital controls to help stabilize the falling peso.

Our overall outlook remains cautiously optimistic given supportive EM corporate fundamentals, the high carry profile of the asset class and the persistent global bid for yield.

EM IG, HY and CEMBI



As of 30.09.2019	JPM CEMBI[7]
Q3 2019 performance in %	1.66
Credit spreads (bps)	338
Yield to worst in %	4.75
Duration in years	5.48

Date: 30.09.2019. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of your investment can go up and down, and you could lose some or all of your invested money.** 6) Source: J.P. Morgan. Date: 30.09.2019. 7) JPM Corporate Emerging Markets Bond Index Broad Diversified in USD.

In Focus

In a low interest rate universe: seek for active management

The tales of a low (negative) yield environment do not belong to the past and are likely to remain our reality for a while. **Safe investments are highly challenged to deliver even the slightest positive return. Reaching for longer maturities or riskier assets might be strategies we feel bound to adopt... taking higher risk or deteriorating quality with quite uncertain results.** From the low pick-up of longer durations in the safe segment, to the risky bet of decreasing asset quality in a late cycle environment, those decisions damage the profile of the safe allocation pocket with in our view low risk-adjusted potential. On the other hand, if you keep the mindset of a buy and hold approach – i.e. reaching for the highest coupon in a depressed yield world – or index tracking investments, the safe fixed income space is indeed not bringing much hope neither. **Nevertheless, in this field, active management is a true game changer! Relative value opportunities are just as present in a market with negative yield levels,** as in a market with higher yields. At Nordea, we stay true to our safe investment offering: managing covered bonds in a very active and dynamic way is our expertise! Our covered bond investment solutions offer high-quality investments combined with the attractive returns that only an active and seasoned manager can bring to your portfolio.

We seek to invest in bonds that offer attractive relative value compared to investment alternatives with similar risk characteristics. Our investment team has a considerable expertise in the inefficient covered bond space, with an incredible strength in **generating alpha over the years: an average of +1.3% net of fees since inception!*** As our investments are entirely focused on relative value and credit selection – essential alpha component – active management is key to generate returns in a depressed yield environment.

Focus on the Nordea 1 – European Covered Bond Opportunities Fund!

The Nordea 1 – European Covered Bond Opportunities Fund clearly shows a great potential in this environment. With a lowered duration, i.e. a minor exposure to interest rate risk, the solution allocates the essential of its risk budget to spread risk. From our traditional strategy, the spread exposure – hence the basis of our alpha capabilities – is doubled with an increased freedom for our investment team to invest in our highest convictions. This solution is not only providing a **high exposure to an attractive driver** but is also managed: first, in a very active and dynamic approach, and second, by **the experienced investment team that brought to life the active management story in the covered bond space!** Relative value opportunities may be one of the few sources of returns you can find today in the safe fixed income space. This approach expands the exposure, and the convictions, that our investment team finds the most attractive in the market: a forthright stance to scale up alpha potential!

* Source: Nordea Investment Funds S.A. Time period: 30.01.2012 – 30.09.2019. Average outperformance of the Nordea 1 – European Covered Bond Fund BP-EUR over the Iboxx EUR Covered Bond Index, net of fees, in EUR, on calendar year basis. **The performance represented is historical; 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, you could lose some or all of your invested money.**

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 2019 (in %)	Effective duration (years)	Effective Yield (in %)
US Corporate Bond Fund	LU0458979746	BP-USD	BBB+	2.97	7.58	3.03
US High Yield Bond Fund	LU0278531610	BP-USD	BB-	2.01	2.61	5.09
European Financial Debt Fund	LU0772944145	BP-EUR	BBB-	1.77	3.34	3.18
European Covered Bond Fund	LU0076315455	BP-EUR	A+	1.73	5.07	0.30
Emerging Market Corporate Bond Fund	LU0634509870	BP-USD	BB+	1.64	4.64	4.88
European High Yield Bond Fund II	LU0602543117	BI-EUR	BB	1.39	3.31	3.61
European Corporate Bond Fund Plus	LU0533593298	BI-EUR	A-	1.31	5.27	0.69
North American High Yield Bond Fund	LU0826399429	BP-USD	BB-	1.25	2.75	5.93
International High Yield Bond Fund – USD Hedged	LU0826393653	BP-USD	BB-	1.15	2.85	6.22
Low Duration US High Yield Bond Fund	LU0602537069	BP-USD	BB	1.12	1.16	3.37
Unconstrained Bond Fund – USD Hedged	LU0975281527	BP-USD	BBB+	1.04	1.81	2.90
European Cross Credit Fund	LU0733673288	BP-EUR	BB+	0.85	3.99	1.91
European High Yield Bond Fund	LU0141799501	BP-EUR	BB+	0.73	2.42	3.70
Renminbi Bond Fund[A]	LU1221952010	BP-CNH	AA-	0.59	1.59	3.03
Global High Yield Bond Fund	LU0476539324	BP-USD	BB-	0.58	2.90	4.67
Flexible Fixed Income Fund	LU0915365364	BP-EUR	AA+	0.47	1.03	0.76
Low Duration European Covered Bond Fund	LU1694212348	BP-EUR	A+	0.38	0.92	0.33
European Covered Bond Opportunities Fund	LU1915690595	BP-EUR	BBB-	*	–0.32	0.49

* Due to local regulatory restrictions, we are not allowed to show performance on share classes less than 1 year old.

A) 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.