

Fund Update - Special

For professional investors only*



November 2017

A slow recovery

Nordea 1 – Flexible Fixed Income Fund
ISIN: LU0915365364, BP-EUR

The objective of this write-up is to explain the key factors behind the fund's performance since it peaked in August 2016, and to shed some light on why we believe the portfolio remains a very attractive investment solution for investors looking for a pure fixed income portfolio, able to preserve capital over a full investment cycle in this low yield environment.

How have markets and the portfolio evolved since the fund reached its peak back in August 2016?

The market environment over this period can be divided into three different phases:

1. Reflation (01.08.2016 – 08.11.2016)

After a volatile first half of 2016, characterised by high quality government bonds performing very well, in early August investors' sentiment started shifting driven by improving growth and inflation expectations. These factors gave some support to high yielding fixed income sub-asset classes and pushed government bond yields higher across the Atlantic.

2. US Election (09.11.2016 – 16.12.2016)

Following an initial slump which lasted a few hours, investors shifted their focus to the pro-growth agenda of the newly elected president and on the tailwind that the US economy already had. Thus the sell-off in safe assets persisted, as markets priced in even higher growth and inflation. In particular, US yields continued to spike aggressively. In the meantime, Trump's protectionist agenda and higher US yields motivated a correction in Emerging Markets (EM) fixed income assets.

3. Cyclical Rally (17.12.2016 – 31.10.2017)

High yielding fixed income sub-asset classes – from both developed markets (DM) and Emerging markets (EM) – rallied on the back of strong economic indicators, supportive earnings momentum and positive developments on the geopolitical side (e.g. French elections). Meanwhile, US yields were moderately lower as the reflation agenda cooled-down a bit following little progress on tax reform, infrastructure spending and new protectionist policies.

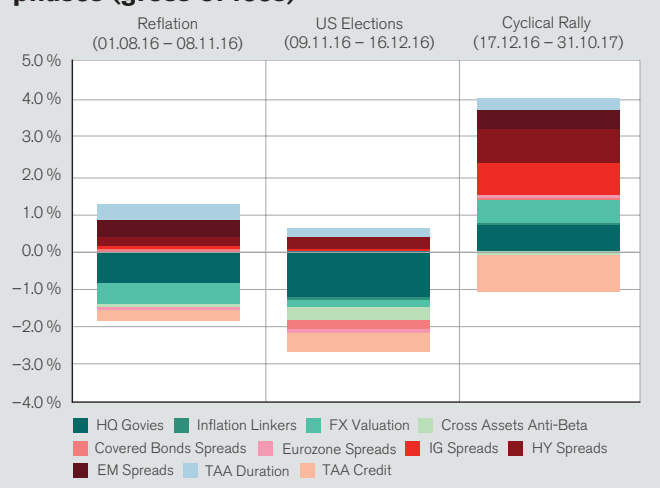
Returns in the different market phases¹

Performance	Reflation (01.08.16 – 08.11.16)	US Elections (09.11.16 – 16.12.16)	Cyclical Rally (17.12.16 – 31.10.17)
N1-FFIF (BP-EUR)	-0.84%	-2.11%	2.17%
US 10 years Treasury (USD)	-2.67%	-5.15%	1.72%
BofA Merrill Lynch US High Yield Index (USD)	2.88%	1.17%	8.24%

Did the fund behave as expected over these periods?

The Nordea 1 – Flexible Fixed Income Fund peaked in August 12th 2016 and then sustained a drawdown of -3.72% which bottomed out by December 15th the same year². The portfolio then started rebounding – and was very close to recover the drawdown in early June – before it began moving downwards again, subsequently closing October 2017 at -1.56% below last's year maximum level³.

Performance contributions in different market phases (gross of fees)⁴



1) Source: Bloomberg and Nordea Investment Funds S.A. Period under consideration: 01.08.2016 – 31.10.2017. The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. 2) Source: Nordea Investment Funds S.A., Period under consideration: 12.08.2016 – 15.12.2016. The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. 3) Source: Nordea Investment Funds S.A., Period under consideration: 12.08.2016 – 31.10.2017. The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. 4) Source: Nordea Investment Management AB. Performance contributions based on the Nordea Flexible Fixed Income Strategy (gross of fees). Period under consideration: 01.08.2016 – 31.10.2017. The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.

It's important to remember that the objective of our risk balanced approach is to protect the portfolio in scenarios where spreads sell off considerably, as these can generate long term losses for investors' portfolios. That is why we make sure to have equilibrium between the green/diversifying return drivers (those that are negatively correlated to equity beta) and the red/pro-cyclical return drivers (those that are highly correlated to equity beta). As such, diversification between the two families of return drivers is key for our investment approach.

If we look into the underlying drivers' behaviour within the aforementioned periods we find:

1. Reflation (01.08.2016 – 08.11.2016)

The portfolio's green/diversifying return drivers – mostly Duration and FX Valuation – weighed down on the fund's performance. The drawdown was further amplified by the fact that as HY spreads continued to tighten we had a low strategic conviction on them and we were tactically reducing the HY credit sensitivity of the portfolio during most of the period. This implied that the red/pro-cyclical return drivers of the portfolio (particularly HY spreads) didn't compensate for the losses from the defensive components. Only our exposure to EM spreads and a tactically lowered duration that contributed materially positively to performance.

2. US Election (09.11.2016 – 16.12.2016)

The strong spike in interest rates hurt the fund's performance since its duration increased from 1yr to 3yrs in November as a response to more attractive expected returns (steeper yield curves) and better diversification benefits to HY risk. A tactical duration risk reduction and exposures to red/pro-cyclical return drivers only partially mitigated the losses from government bonds (duration), while a tactical credit risk reduction detracted to performance.

3. Cyclical Rally (17.12.2016 – 31.10.2017)

The main drivers of the positive performance were the red/pro-cyclical return drivers (IG, HY and EM spreads), but most of the green/diversifying return drivers were also positive (the FX valuation strategy performed particularly well). While our tactical credit model detracted considerably due to its risk-reducing stance on already compressed HY spreads' levels, our tactical duration model worked well during the sizeable swing seen in yields over Q2 and Q3 2017.

Why is the Nordea 1 – Flexible Fixed Income Fund an attractive solution for investors in the current low yield environment?

While investors continue to look for yields and expectations about increasing rates dominate markets, many unconstrained fixed income managers have loaded their portfolios with HY credit and/or EM debt 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 offers investors a good alternative to balance out the sizeable amount of credit risk embedded in their portfolios. The Multi Assets Team's (MAT) focus on diversification will periodically translate into higher levels of duration and a relatively smaller allocation to credit, compared to what most peers have today.

Moreover, although the fund experienced one of its largest drawdowns since 2013 last year, it should be noted that it was still in line with previous corrections and a volatility of around 3% for the fund (which is well within our 2–5% ex-ante volatility range). Despite the fall, the fund's long-term track record remains attractive given its contained level of risk and the challenging low yielding environment.

As of the end of October 2017, the annualised return of the fund was 1.82%, with a volatility of 2.81%⁵. This figure well exceeds the overall target return of cash +2% p.a. (gross of fees) over an investment cycle (as it has done every full calendar year since the fund's launch), and our team believe we can consistently achieve this while building a portfolio with a very low probability of losses over the same investment horizon⁶.

5) Source: © 2017 Morningstar, Inc. All Rights Reserved. Data as at: 02.11.2017. European Open End Funds database. Period under consideration: 01.06.2013 – 31.10.2017. Performance in EUR and based on monthly observations. **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.** 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. 6) **There can be no warranty that investment objectives, targeted returns and results of an investment structure are achieved.**

Source (unless otherwise stated): Nordea Investment Funds S.A. Period under consideration (unless otherwise stated): 01.08.2016 - 31.10.2017. Performance calculated NAV to NAV (net of fees and Luxembourg taxes) in the currency of the respective share class, gross income and dividends reinvested, excluding initial and exit charges as per 31.10.2017. Initial and exit charges could affect the value of the performance. **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.** 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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