CQS Credit Multi Asset Fund

Review for Dorset Council Pension Fund

Q1 2019 update

All Investors should ensure that they have received and read the latest Offering Documentation and Prior-Investment Disclosure document which is available from CQS at clientservice@cqsm.com

Summary

CQS

Portfolio Summary

- CMA's objective is to achieve a target return of Libor+4–5% p.a. with single digit volatility[1]
- CMA is a long-only, actively managed global credit portfolio
- Invests predominantly across Loans, High Yield and Financials, Asset Backed Securities and Convertible Bonds
- Maintains low interest rate duration (capped at two years) and does not use financial leverage[2]

Performance Update (Performance Index GBP)[3]

Annualised Return Since Inception (% p.a.)	Annualised Volatility Since Inception (%)	Sharpe Since Inception	Q1 2019 Return (%)
4.77	2.20	1.90	2.87

Dorset Council Pension Fund's return on initial investment:
+3.48% net (since 1 December 2017)

AUM in CMA: **£140m** as at 31 March 2019

2018 Performance

- 2018 full year returns were led by loans, with good performance from the US loans portfolio although returns from Europe were also positive
- The other positive contributor was ABS, which remains balanced between US residential mortgage-backed securities and European CLO liabilities
- Other allocations were flat to negative. Investment Grade (Financials) were flat to slightly down and convertibles down by 0.21% as a consequence of volatility in equity markets (particularly in Q4)
- High yield had a volatile year, finishing the year lower in both Europe and the US. Most of the underperformance came in Q4, when volatility picked up substantially and we saw substantial decompression in credit spreads

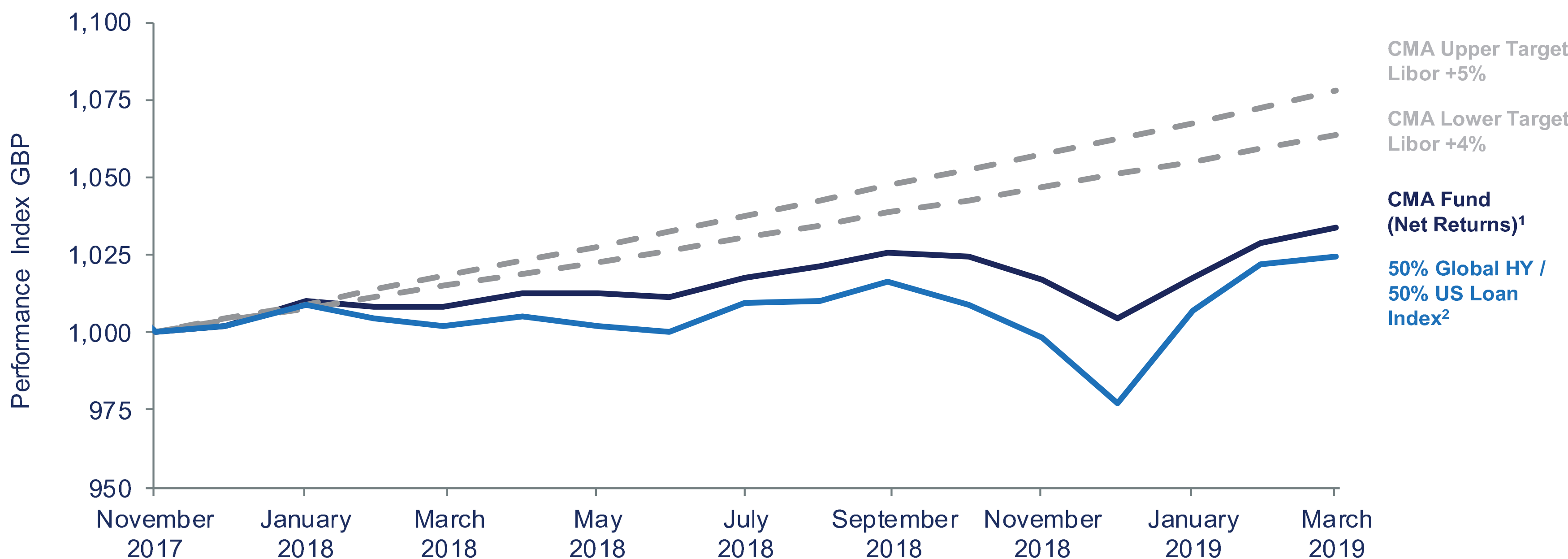
Q1 2019 Performance

- All asset classes contributed positively to returns, with mark-to-market gains supported by income
- Loans led the way, given the size of the allocation, followed by high yield. Within loans, the performance of the US strategy was especially strong. Returns were equally split between the US and Europe for high yield
- Higher beta CLO liability performance contributed well within ABS, while convertibles and financials added value
- By geography, Europe contributed slightly more than half the investment performance year-to-date

Please note, returns reference the Performance Index GBP, a theoretical, non-investable share class which is made up of a series of share classes in order to demonstrate the longest consistently available track record for the Fund. A breakdown of the index formulation is included at the end of the presentation.

Source: CQS as at 29 March 2019. [1]Target returns are estimated and net of fees, expenses and income reinvested. They are based on long-term performance projections of the investment strategy and market conditions at the time of modelling and are therefore subject to change. There is no guarantee that any target return can be achieved. Investors should not place any reliance on such target return in deciding whether to invest in the Fund. [2]Except when required for currency hedging purposes.[3]Returns represent the Performance Index GBP. Please refer to the end of the presentation for further details as to how this index is constituted. This presentation includes historic returns and past performance is not a reliable indicator of future results. The value of investments can go down as well as up.

CQS Credit Multi Asset Fund (CMA) Performance vs. Target and 50/50 Index



	Q1 2019	Last 12m	Since initial investment 1 December 2017
CMA investment return (Net of fees, GBP)	2.87%	2.49%	3.48%
Index investment return (Gross, GBP hedged)	4.83%	2.25%	2.45%
LIBOR+4% (GBP)	1.19%	4.77%	6.35%

Please note, the Performance Index GBP is based on a theoretical, non-investable share class. It is made up of a series of share classes in order to demonstrate the longest consistently available track record for the Fund. A breakdown of the index formulation is included at the end of the presentation.

Source: CQS as at 29 March 2019. [1]Returns reference the Performance Index GBP. [2]50/50 Index is a blended benchmark return comprising the US LLI (Leveraged Loan Index) and the Global High Yield Index (HW00) expressed in Hedged GBP terms. The index is included merely to show the general trends in the period indicated and is not intended to imply that CMA is similar to the index in composition or risk. This presentation includes historic returns and past performance is not a reliable indicator of future results. The value of investments can go down as well as up.

Investment Commentary – Q1 2019

Market background

- The performance of credit markets in Q1 was almost a mirror image of the final three months of 2018. High yield led the way with a return of 7.38% in the US and 5.26% in Europe, followed by high beta convertible bonds, with a return of 6.64% from the index, and Financials with a return of 5.68%. Loan markets largely recovered, with a return of 3.96% in the US and 1.85% in Europe, all in local currency terms.
- Strong financial market performance was led by equities, rebounding from a weak finish to 2018 as concerns over the trade dispute between the US and China eased, and major central banks grew more accommodative. Higher beta credit assets fully participated in this, with high yield markets finding additional technical support as retail investors in particular moved to seek duration given the shifting central bank stance.
- This, along with limited new issue supply, left high yield markets in a very positive technical position. Although spreads tightened in the US market, it was a risk-off rally, with BB rated bonds outperforming B and CCC rating tiers. Credit spreads also tightened in Europe, with single B rated bonds outperforming both lower and higher rated sub-investment grade debt.
- With strong gains for global equity markets, convertible bonds benefited from a significant tailwind during the quarter. The quarter also marked the strongest three-month period of performance yet seen for additional tier 1 financial assets, helped by a broad-based rally in risk-assets globally and demand for fixed-rate fixed income as investors sought yield.
- While retail outflows continued from the US loan market, a further $11bn, the much more important collateralised loan obligation market continued to function well and the secondary market rallied strongly as institutional investors took advance of mark-to-market volatility in Q4 to increase exposure. Primary issuance remained light, though still higher than Q4 2018.
- Asset Backed Securities continued to hold up well in this environment, with residential mortgage backed securities and credit risk transfer securities both providing to be technically very well positioned, with strong demand and a shrinking supply as legacy residential mortgage backed securities amortise. Collateralised loan obligations by contrast saw spreads drift a little higher for longer dated paper, presenting some interesting opportunities for investors.

Investment strategy and outlook

- We started the period with 53% in loans, 20% in ABS, 12% in high yield, just short of 4% in convertible bonds and 3% in financials. Unallocated capital was 8%. We shifted our geographic and asset class focus to capture opportunities in an oversold US high yield market during the quarter, taking our exposure to US high yield from 5.1% at the end of December to 7.3% by the end of March.
- We also added a new investment grade corporate strategy to capture opportunities in the relatively attractive and fundamentally defensive BBB bond space. This accounted for 1% of the Fund at the end of March. Together with an increase in the existing Financials strategy, from 2.9% at the end of December to 3.3% by the end of March, this took the Fund's interest-rate duration from 1.27 to 1.46 years over the period. Bank loans continued to provide core income to the portfolio and have generated excellent risk-adjusted returns.
- Strategic allocations remain similar to historic levels, with some tactical allocations to capture lagging asset classes; we have increased CLO liabilities in light of the longer-term relative value we see in this area of the market, added to US and European investment grade, and raised exposure to US 2nd lien loans. At the end of March we held 51.0% in loans, 22.2% in ABS, 13.3% in high yield, 3.5% in convertible bonds, 3.3% in financials and 1.0% in investment grade. Uncommitted capital was therefore just under 6%.
- As we look forward through the rest of 2019, I'd like to emphasise the ongoing critical importance of agile asset allocation in this environment, and careful fundamental research. We remain highly diligent with respect to the fundamental performance of individual businesses, and discipline with respect to our investment process, principles and philosophy is essential.
- After the strength we have seen in markets in recent months, we believe it is appropriate to be positioned relatively conservatively, favouring allocations to senior secured loans and ABS over high yield bonds and convertibles. We continue to see excellent investment opportunities on an idiosyncratic basis provided we stay disciplined and active with respect to fundamental credit selection.
- As we stand today, our target exposure to loans is approximately 52.1%, ABS is 22.75%, high yield is 13.75%, financials is 3.4%, investment grade is 1.75% and our target exposure to convertibles is 3.65%. The target cash weighting is, therefore, 2.6%. The Fund's overall yield is currently 5.37% in Sterling terms at the end of March, while almost 80% of the Fund remains invested in floating rate instruments.

Source: CQS as at 29 March 2019. The Fund may have since exited some or all of the positions detailed in the above commentary. Quoted Fund returns reference the Performance Index GBP. Investors should note the base currency of the Fund is in US dollars. All market data sourced from Bloomberg, MSCI, Barclays, BofA Merrill Lynch, Markit and UBS.