October 2018

InFocus

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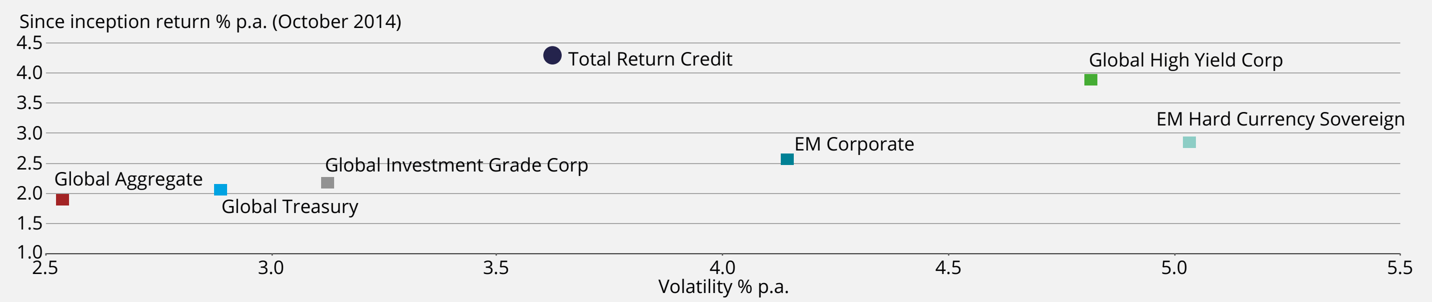
Standard Life Investments Total Return Credit Fund

Key features

Seeks to deliver a compelling return over the course of a credit market cycle by investing across the global credit universe	Aims to reduce volatility and minimise drawdowns through a set of tailored drawdown-protection strategies	Lower sensitivity to interest rate risk bias, and a focus on higher-yielding credits

Performance



Source: Aberdeen Standard Investments, Barclays Indices: Global Aggregate, Global Aggregate Corporate, Global Treasury, Global High Yield Corporate, Emerging Market Hard Currency Aggregate Sovereign, Emerging Market Corporate (10% country capped), monthly returns hedged to GBP, 31 October 2018

	31/10/2017 to 31/10/2018 (%)	31/10/2016 to 31/10/2017 (%)	31/10/2015 to 31/10/2016 (%)	31/10/2014 to 31/10/2015 (%)	31/10/2013 to 31/10/2014 (%)
Total Return Credit (SICAV) (Gross performance in GBP)	-0.33	4.76	8.65	4.07	n/a
IA Sterling Strategic Bond (Gross performance in GBP)	-1.03	4.95	7.23	2.01	5.27

Source: Aberdeen Standard Investments - Total Return Credit Gross performance in GBP; FE Analytics - IA Sterling Strategic Bond Gross performance in GBP

Performance is shown gross of fees and does not reflect investment management fees. Had such fees been deducted, returns would have been lower. Past performance is not a guide to future results.

When the going gets tough…

One of the key differentiating features of the Total Return Credit Fund is our use of drawdown-protection strategies that aim to offer some degree of protection during periods when credit markets come under pressure. Among our downside-protection strategies, we currently hold three insurance positions.

- **The first of these benefits when volatility in the US Treasury market increases, irrespective of the direction of US interest rates.**
- **We bought a 'put' option on the US S&P 500 Index, which will allow us to profit if the S&P 500 Index falls.**
- **A third position benefits from an increase in European equity market volatility.**

These strategies complement other positions in the portfolio that we expect will benefit from further escalation in the trade war rhetoric. One of these is our currency position preferring the US dollar over the Australian dollar. Given Australia's strong trade links with Asia, trade developments that undermine Asia will feed through to the Australian economy, which is already showing signs of strain. At the same time, such an environment would also lead to a firming of the US dollar, which would further support this strategy.

Aberdeen Standard Investments

During August, appetite for risk waned in credit markets. As a result, riskier segments of the market such as global high yield delivered negative returns of around -0.20%. Against this backdrop, the Total Return Credit Fund returned +0.15%. This positive performance was largely attributable to the drawdown protection strategies, which worked as designed, delivering a return of 0.29%. This continues the Fund's track record of strong upside capture and limited downside capture. Since inception, the Fund has captured 97% of 'up' markets and only 67% of 'down' markets.

No shortage of credit opportunities

While our downside-protection strategies provide a valuable cushion during periods of market stress, it is of course credit selection that is the primary driver of the Fund's returns. Most investors agree that, after the strong performance of corporate bonds in recent years, the environment has become more challenging and we are unlikely to enjoy such stellar returns in future. However, for investors with the resource and motivation to dig deep, global credit still offers plenty of attractive long-term investment opportunities.

Down the line
Telecom infrastructure is a relatively nascent and rapidly expanding area in many emerging economies. In Africa's high-yield credit market, telecom infrastructure company Liquid Telecom offers value.

Liquid Telecom is uniquely positioned in terms of its 'fibre footprint' and its relationship with regulators to continue expanding into new geographies across Africa. At the same time, existing relationships provide scope for the company to offer new business lines. As such, capital expenditure is likely to remain high for the next few years. However, management is very clear it does not want to incur additional debt or raise equity, seeking instead to fund the spending from existing cash and operating cash flow – we believe this is achievable at current or higher levels of revenue growth and profitability.

Data-driven
In tandem with the proliferation of digital data has come increasing demand for data centres where companies can securely store, manage and disseminate their data, and house their most critical systems and equipment. This is a sector we like globally. In particular, we like Mexican IT outsourcer **KIO Networks**, Mexico's fastest-growing provider of data centres.

KIO Networks pays an attractive 8% yield, over 1% higher than the European high-yield credit index. Importantly, the company has secured several significant contract wins in recent years. These include health data digitisation and other government contracts that are long-term and defensive in nature, providing sustainable revenue streams.

Solid foundations
One of our preferred developed-market names is US housebuilder **MDC**. Although not one of the largest in the sector, it operates in some of the most desirable regions and is the least indebted of its peers.

The housebuilding sector has underperformed this year, as rising US interest rates have fuelled fears about affordability. We take a more sanguine view – the labour market is strong and we believe rates will rise at a slower pace and by less than the market expects, despite the robust performance of the US economy.

A particular feature of the TRC Fund is that we do not restrict ourselves to any given geography, credit asset class or maturity profile – rather, we invest wherever we believe there are opportunities. We took advantage of this flexibility to buy MDC's long-dated (30-year) bonds, where prices had reached especially compelling levels and offered a very attractive entry point.

What's in store for credit?

Amid trade wars, political uncertainty and rising interest rates, we are entering a much more nuanced environment for credit. Markets are likely to be more volatile and investors will likely have to search more widely for returns. We believe flexibility and strong credit selection will be crucial in delivering solid investment performance. With its focus on delivering attractive returns to investors while cushioning against downside risk, the Total Return Credit Fund should be well-placed.

Issued by Standard Life Investments Limited, which is registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL and authorised and regulated by the Financial Conduct Authority in the UK.

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