PICTET 1805

Pictet Asset Management | July 2015

For professional investors only

Absolute Return Fixed Income Strategy

Monthly Newsletter (USD)

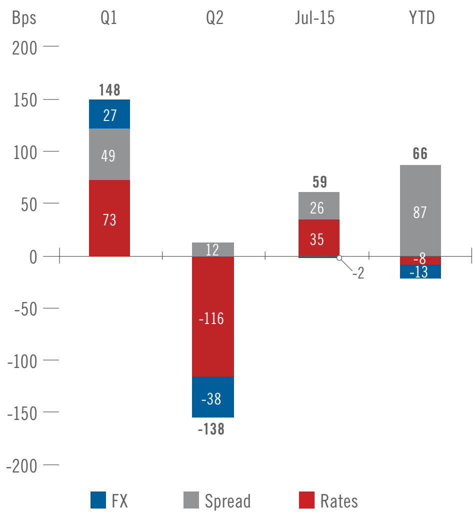
Performance analysis July 2015, gross of fees

LONG TERM STRUCTURAL THEME	STRATEGY	PERFORMANCE
Low Rates For Long	Long US Duration in the long end of the curve	⊕
	Long US Duration versus short European Duration	⊖
	Long non financial US and European Credit	○
European Crisis	Long positions in European senior and Subordinated financial bonds	⊕
	Curve flattening positions in the Italian and Spanish government curves	⊕⊕
	Euro underweight versus US Dollar	○
Abenomics	Short Korean Won versus Dollar	○
Chinese Transition	Long Emerging Market US Dollar and Euro Debt	○
	Long selected local Emerging Markets Debt	○
	Short selected Emerging Market currencies	⊖

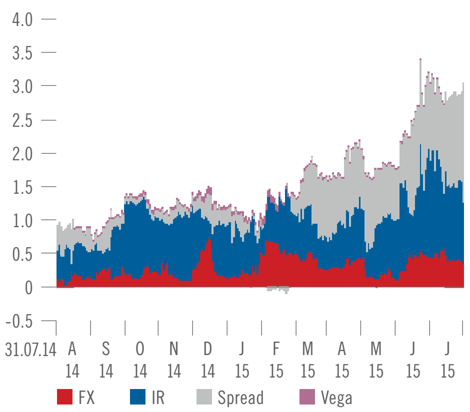
Performance key

⊕⊕ very positive: > +50bps
⊖⊖ very negative: < -50bps
⊕ positive: [+10bps; +50bps]
⊖ negative: [-50bps; -10bps]
○ neutral:] -10bps; +10bps [

Monthly performance attribution by alpha source*
in bps, gross of fees



Volatility contribution by risk type * in %



Portfolio characteristics*

Modified Duration	2.28
Yield to Maturity (YTM)	1.4%
Average Coupon	1.6%
Number of Issuers	161
Number of Holdings	221
Number of Sectors	15

*Data taken from the Pictet-Absolute Return Fixed Income fund, which is included in the composite.

All data presented as at 31.07.2015 in USD

Source: Pictet Asset Management

Composite performance[1]

Annualised %	MTD	QTD	1Y	Since inception[2]
Global Fixed Income Composite Absolute Return Consolidated	0.58	0.7	1.9	3.4

[1]Gross of fees in USD, 31.07.2015. [2]Inception date 31.08.2012.

Market review

Rates

After several challenging months, with the Greek crisis dominating market price action, developed market government bonds ended the month strongly. Yield curves flattened across the board after a proposed restructuring deal was approved by the Greek, despite being more austere than that rejected in the July Greek referendum. German Bunds and European peripherals performed strongly as the Eurozone remains intact for the time being. With solid gains in the US labour market data, the US Fed kept rated unchanged but added the word "some" in the FOMC statement suggesting that any potential rate move is still data dependent. The US yield curve flattened as focus shifted back to the US growth outlook and renewed weakness in the oil market. In terms of central bank action elsewhere, Brazil hiked rates, while Canada and Sweden cut rates.

Spread

Euro credit and sovereign bond spreads have reacted very favourably to the more constructive outlook for Greece, with the prospects for a reform package and negotiations on a third bailout. Relief on the outlook for Greece was also supportive for Emerging Market issuers, in both hard and local currencies. In developed markets, financial subordinated bonds outperformed other sectors, while China's slowing economy and the continued oversupply in oil dragged down energy and commodity-related issuers.

FX

US dollar performed strongly against most currencies in July. In addition to being impacted by the developments in Greece, the currency markets were also subject to the volatility of the Chinese equity market, which the Chinese government has been trying to dampen. The ongoing weakness in commodity prices, especially the 20% drop in oil prices, has also negatively impacted commodity currencies. The worst performing currencies were the Colombian peso, Russian ruble and Brazilian real, along with other commodity currencies.

Performance analysis

The portfolio was positive on performance terms this month. The main contributors from rates were our overweight in duration in the US Treasury market, our US Treasury curve flattener and our curve flattening positions in Spanish and Italian long maturity government bonds. In spread, our overweight in subordinated financials in Europe was positive as was our underweight in Emerging Currencies notably the Chilean and the Colombian peso versus the US dollar for our currency positions. On the negative side the portfolio was impacted by our commodity currency overweight versus the US dollar and our small allocation the Mexican the Brazilian and Turkish government bonds.

Portfolio activity

During the month dominated by volatile Greek headlines, we focused on stabilizing the portfolio. We increased our curve flattening exposure in the European periphery. We have also further reduced our exposure to commodity currencies and closed Norwegian Krona positions, but increased short in emerging market currencies like the Chilean and Colombian peso.

Market outlook

At the end of last year we started to diversify our long US dollar exposure on the view that a more dovish central bank in China would give some support to the already battered complex of Emerging and Commodity currencies around the world. Seven months later we find that the Chinese economy has barely stabilized, the stock market is in disarray, commodity prices are even lower and that nominal exports in the Emerging world are even weaker. Chinese fiscal and monetary policy continues to aim at rebalancing growth towards a more consumer-led model and at the same time make the CNY a global reserve currency. The first objective will take time to be achieved but most evidence points in the right direction. The second one is also on its way to be achieved but the IMF has just announced that it will have to wait until the second half of 2016. It could be quite a challenge for China to keep its currency stable until then if it fails to stabilize its economy and stock market. It will be even more challenging for the rest of the emerging world to stabilize their currencies and their economies without increasing rates further. Given this mediocre growth and inflation backdrop around the world, we believe that the rate hiking cycle that is about to start in the US will be a particularly shallow one, with rates peaking below 2.5%. In this context the US Treasury curve should continue to flatten.

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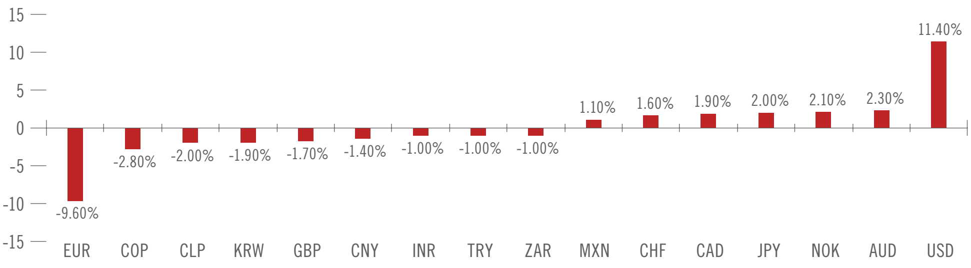
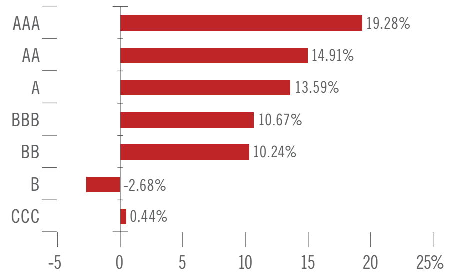
Portfolio strategy

LONG TERM STRUCTURAL THEME	STRATEGY	RATIONALE	CHANGES DURING THE PERIOD
Low Rates For Long	Hold overweight duration in the US Treasury curve.	With rates stable and no inflationary pressures in sight investors should find valuations attractive in the US Treasury curve where a full tightening cycle is priced.	We renewed our bias towards the long end of the curve in the light of the steepening seen during Q2 2015 and a more hawkish Fed rhetoric.
	Hold long US Duration versus underweight European Duration.	The market is currently pricing continued divergence in rates between the US and Europe. We believe that this is unlikely to continue with the ECB doing QE and growth disappointing in the US.	
European Crisis	Hold long positions in European senior and subordinated financial bonds.	With enormous regulatory pressure to reduce the size of their balance sheets and improve their capital ratios European banks should continue to improve their credit standing and optimize their capital structure.	Given the spread widening resulting from the Greek crisis we have reinstated our overweight in European Senior Financial bonds.
	Hold curve flattening positions in the Italian and Spanish government curves.	The ECB's aggressive QE program if successful should compress long term spreads between Germany and the periphery and increase inflationary expectations for the Euro area. Currently the market prices wider spreads in the long term for the periphery and low inflation for a prolonged period of time.	
	Hold Euro underweight versus US Dollar.	We believe that the deflationary threat will eventually push the ECB to continue steady in their quantitative easing which should undermine the value of the Euro relative to other currencies.	
Abenomics	Hold a tactical underweight in the Korean Won versus the Japanese Yen.	Surprisingly the Bank of Japan seems comfortable with the current level of the exchange rate. With the Bank of Korea easing policy to compensate for the current export slump and the Chinese economy failing to rebound we believe the Yen looks cheap relative to its main competitor in the Asian market.	
Chinese Transition	Hold long positions in Emerging Market US Dollar and Euro Debt.	After the last 12 months sell-off in Emerging Market debt, spreads and absolute yields are very attractive as there hasn't been a significant deterioration on most Emerging Market's capacity and willingness to pay their debt.	
	Hold short currency positions in selected Emerging Market currencies.	Given the slowdown in the Chinese economy demand for commodities should remain subdued. This should translate in weaker growth as well in the Emerging world. To adjust to this new reality Emerging central banks should depreciate their currencies.	
	Hold a small diversified exposure to developed commodity currencies.	The risk to our strategy is that China begins to ease policy in a more aggressive way weakening the US Dollar and supporting commodity prices.	

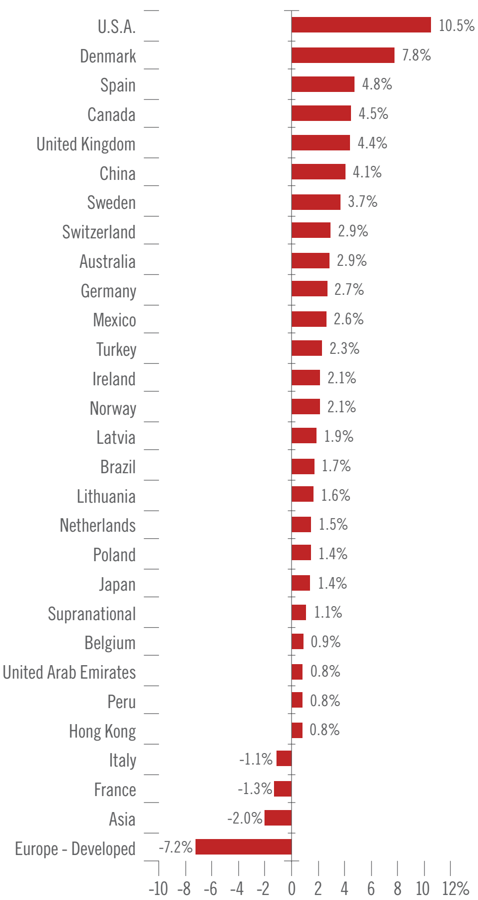
Currency deviation relative to the base currency (USD)* in %



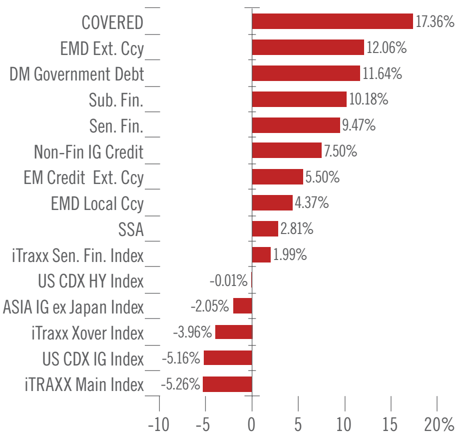
Investment rating breakdown (cash bonds only)* in %



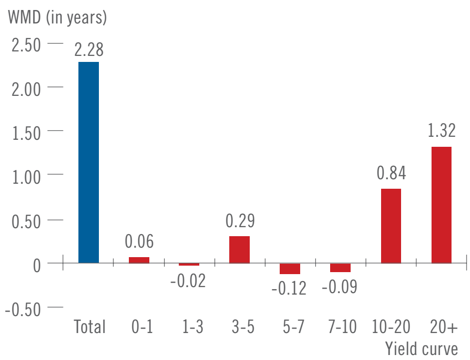
Country breakdown* in %



Sector breakdown* in %



Duration contribution* in years



Top 10 issuers*	Weight (%)
United States of America	12.8
iTRAXX Main Index	-5.3
US CDX IG Index	-5.2
iTraxx Xover Index	-4.0
France	-3.7
Spain	3.1
Italy	-2.8
Nykredit Realkredit A/S	2.4
ASIA IG ex Japan Index	-2.0
iTraxx Sen. Fin. Index	2.0

Strategy information

Strategy inception**	31 August 2012
Strategy assets**	USD 1.3 bn
Investment objective	Generate annual returns of 3% to 5% a year over a 3 to 5 year investment cycle
Investment team	Andres Sanchez Balcazar Thomas Hansen Mickael Benhaim David Bopp

*Data taken from the Pictet-Absolute Return Fixed Income fund, which is included in the composite.

**Global Fixed Income Composite Absolute Return Consolidated

All data presented as at 31.07.2015 in USD

Source: Pictet Asset Management

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For further information, please visit our websites
www.pictet.com
www.pictetfunds.com