First State Investments

Strategic Absolute Return Fixed Income

Commentary

3rd Quarter 2019

About First State Investments

We are a global asset manager with established offices across the US, Europe, Australia and Asia Pacific regions. As of September 30, 2019, we manage $151.2 billion of asset under management (AUM) globally, including $54.3 billion in Fixed Income and Multi-Asset strategies.

Fixed Income Capabilities

Global Fixed Income

Strategic Core

Strategic Absolute Return

High Yield

Global Corporate Credit

Emerging Market Debt

Cash Management

Team

Steve Johnson
Head of Global Fixed Income (32)

Ken Bowling
Head of PMs (27)

Steve Willer
Portfolio Manager (24)

John Brennan
Head of Structured (26)

Mike Arnold
Head of Credit (17)

Global Fixed Income Platform:

Over 50 investment professionals located in the U.S., Australia, Asia and Europe covering all fixed income markets

First State Investments Absolute Return Composite. Past Performance is not indicative of future performance. Composite returns do not reflect the deduction of investment advisory fees. A client's return will be reduced by the investment fees. If a client placed $100,000 under management and a hypothetical gross return of 5% were achieved, the investment assets before fees would have grown to $162,889 in 10 years. However, if an advisory fee of 0.4% were charged, investment assets would have grown to $156,490, or an annual compounded rate of 4.6%.

Performance Highlights

- The Absolute Return strategy returned 0.61% during the quarter.
- Interest rate positioning underperformed overall. Losing positions in US breakeven inflation rates and the US yield curve shape were partially offset by successful long rate positions in the US, Europe, and Australia.
- Securitized positions added value. Single family rental bonds performed well. ABS spreads were flat or tighter in all sub-sectors we held.
- IG corporates were basically flat. Good positioning in July and overall tightening in September were offset by systemic spread widening in August.
- HY outperformed in the quarter. We were long throughout the quarter. Gains in July and September exceeded our losses in August.
- FX positions underperformed slightly. Short GBP positions underperformed in September as the British parliament forced PM Johnston to seek a Brexit extension from the EU in the likely event of not reaching a Brexit agreement.

Returns (Gross of fee)

As of September 30, 2019	1mth	3mths	YTD	1yr	3yr	Since Incep.
Strategic Absolute Return	0.22	0.61	2.72	2.15	1.80	1.53
USD LIBOR 3 Month Rate	0.18	0.56	1.86	2.54	1.91	1.51
Relative performance	0.04	0.05	0.86	-0.39	-0.11	0.02

Strategy Characteristics

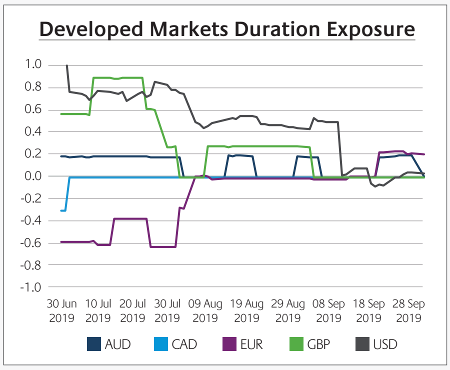
Key Characteristics	
Yield to Worst	3.02%
Modified Duration	1.03
Spread (OAS)	127
Average credit rating	A
Number of issuers	148
Portfolio Holdings	
Cash	0%
Government	2%
Investment Grade Corp Bonds	16%
HY Bonds	13%
Non Agency MBS/CMBS	24%
Non-Agency ABS	36%
Agency MBS/Passthroughs	-15%

Fixed Income Commentary for the period ending September 30, 2019

- Global interest rates continued to fall. In August, Germany joined Denmark and Switzerland in having its entire yield curve trade below 0%. Australia continues to lead the way towards lower rates with its 10YR yield declining 38 bps to 0.96%, a new all-time low. Over the last two years, Australian 10YR yields have fallen a remarkable 1.35% more than US 10YR yields. US 10YR rates fell 33 bps to 1.67%. The mild US curve steepening trend seen in the first half of 2019 reversed, with US 2-10 spreads flattening 20 bps to 0.05%. German 10YR rates followed the global pattern, declining 24 bps to -0.57%. Japanese 10YR rates fell 6 bps to -0.22%, challenging the 0.20% trading band the BOJ has tolerated around its 0.00% rate target. The spread between Italian and German bonds plunged 1.03% to 1.39%, primarily in August.
- The global economic picture was mixed in the third quarter, although there were signs of slowing growth. Lower rates helped economic data surprise on the high side in the US as well as Australia and Japan. The Eurozone notably weakened. Chinese data was less conclusive although turmoil in Hong Kong will likely have an economic and a human cost. Manufacturing data is significantly weaker than non-manufacturing data. Eurozone Manufacturing PMI fell to 45.7 in September (below 50 is contractionary). US ISM Manufacturing fell to 47.8 in September, down from 51.7 in June. Trade tensions ramped up again in August as the US enacted tariffs on China. The WTO expects global trade growth of only 1.2%, the lowest level since 2009. The US is an outlier on inflation. US Core CPI climbed to 2.4% YOY, driven in part by tariffs, but inflation fell just about everywhere else.
- A primary contributor to lower rates has been the ongoing global monetary easing cycle. At least 35 EM central banks announced rate cuts in Q2, joining many DM central banks. The Fed cut rates in July and September but remains divided about further action. Some Fed members see a strong trailing economy while the market remains perpetually disappointed by a Fed they perceive to be overly reactive rather than proactive. The US 3 Month – 10YR spread has been negative since May 23rd, a potential sign of upcoming recession. Outgoing ECB President Draghi cut the deposit rate by 10 bps to -50 bps, introduced a two-tier reserve system, and will restart Quantitative Easing purchases at €20bn/mth. The ECB is also divided about future action as Europe may be approaching the limits of monetary policy effectiveness. New ECB President Lagarde is expected to try to persuade national governments that it is time for fiscal policy to take over as the primary policy instrument.
- Spread sectors were less directional than rates. Corporate sectors widened amidst the market tumult in August but tightened in July and September. US IG corporate spreads ended unchanged at +115. US HY spreads tightened only 4 bps, ending the quarter at +373. EM underperformed, widening 34 bps to +324, as Argentina pricing collapsed. The shocking presidential primary election victory of Peronist candidate Alberto Fernandez caused the market to price in a high likelihood of default. Vicious price action was exacerbated by Argentina's high external financing needs. In the US, interest rate volatility continued to climb from all-time lows set in the first quarter.

Portfolio Summary: Interest Rates

- Interest rate positioning contributed -19 bps to the Absolute Return strategy during the quarter.
- Long positions in US, Australian, and European rates added value, particularly in August.
- US yield curve steepener positioning and long US breakeven positioning lost money despite two Fed rate cuts during the quarter.
- The Fed is in a difficult position as it can model the effect of future tariff regimes, but cannot pre-empt them, leading to the impression that they are behind the curve and reactive rather than proactive. Hence, the yield curve refuses to steepen and breakevens cannot bounce.
- US Inflation pricing is at recessionary levels, well below core CPI, as the market anticipates tariff driven demand destruction.
- Country spread positioning was mixed. We were hurt by German rates outperforming US rates in July. We benefited from Spain and Italy tightening versus Germany in September.



Source: First State Investments

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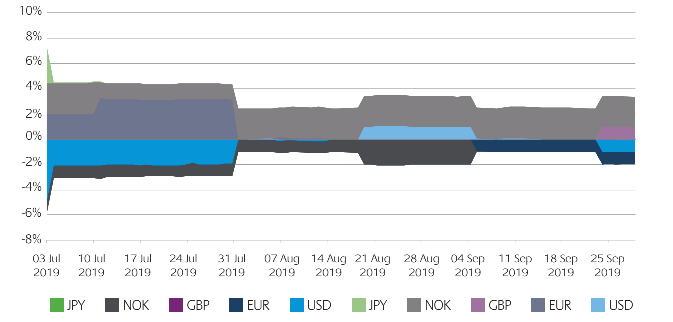
Portfolio Summary: Currency

- Currency positioning contributed -3 bps to the Absolute Return strategy during the quarter.
- We held short GBP positions vs USD and Euro as the prospect of a "no-deal" exit from the EU increased. We removed the positions in September as the British parliament forced PM Johnston to seek a Brexit extension from the EU in the likely event of not reaching a Brexit agreement.
- We held a long NOK position vs SEK and Euro as the Norges Bank raised their policy rate with the Norwegian economy outperforming. Unfortunately this action was seen as a "dovish hike" as the central bank lowered the path of future policy hikes. We still like NOK going forward as an outlier with inflation above target and the unemployment rate continuing to fall.

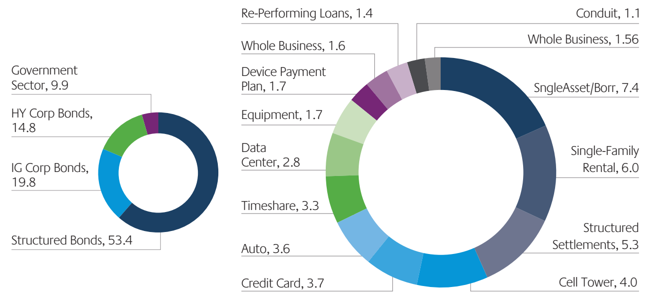
Portfolio Summary: Currency



Portfolio Summary: Securitized

- Securitized positioning contributed +17 bps to the Absolute Return strategy during the quarter.
- Our single family rental holdings performed well. This has become a low beta sector, ignoring the gyrations that affected most of the market. Housing credit benefits from the decline in interest rates.
- ABS spreads were flat or tighter on all sub-sectors we held. Data center ABS performed particularly well, supported by strong fundamentals and wide spreads due to being a new sector.

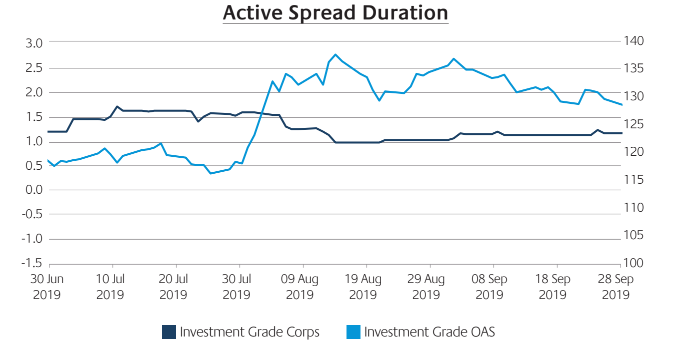
Market Value Allocation



Portfolio Summary: Corporates

- IG corporate positioning contributed -1 bps to the Absolute Return strategy during the quarter.
- We maintained a long position in US IG throughout the quarter. A chaotic and weakening global backdrop has been offset by solid domestic fundamentals and easier monetary policy.
- Gains from good positioning in July and tighter spreads in September offset losses from broad market widening in August.

Active Spread Duration



Portfolio Summary: High Yield

- HY corporate positioning contributed +22 bps to the Absolute Return strategy during the quarter.
- We were modestly long HY throughout the quarter, earning positive returns in July and September.
- Security selection was effective with only modest underperformance in August despite overall market volatility.

Active Spread Duration