



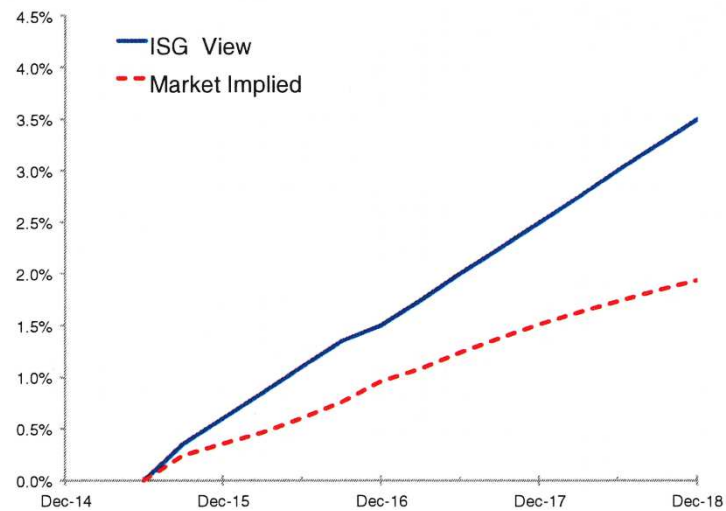
The quest for yield and its dangers

October 2015

Low interest rates

- Ⓜ Rates at historically low levels
- Ⓜ Due to pick up in the US as a start or to remain low for an extended period of time like in Japan?

1. Federal Funds Rate Paths¹



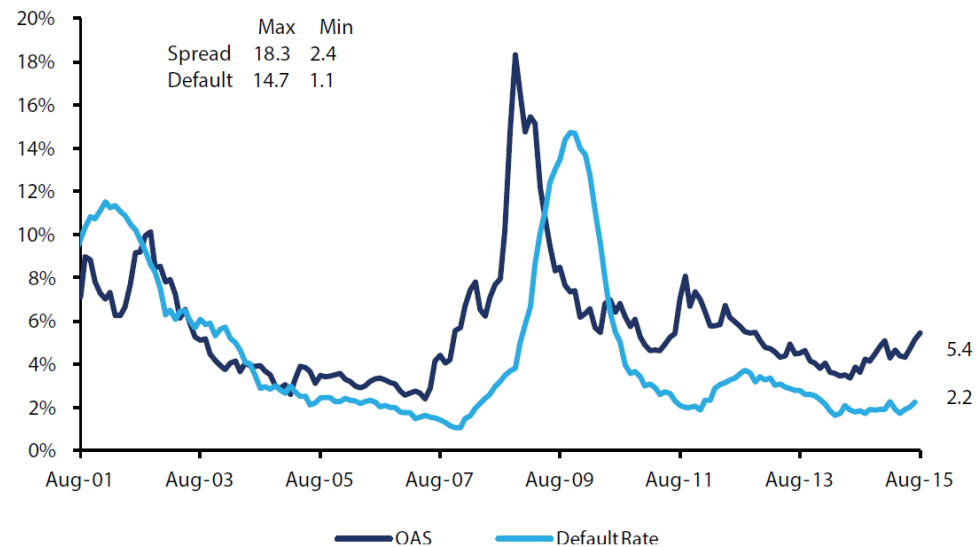
2. Japanese 10-Year Government Bond Yields Since 1900



Tight spreads

- High yield spreads at very low levels although not at historically lower levels. Currently around 500-600bps against lows around 250bps right before the 2007 financial crisis and highs at 2000bps at the peak of the crisis.
- Close to historical low default levels

High Yield Spread Versus Trailing 12m Default Rate



Extremely thin volumes

- Out of a total of circa USD 7.5tr US bonds outstanding, less than USD 25bn are being held by broker dealers.
- Extremely low level of liquidity

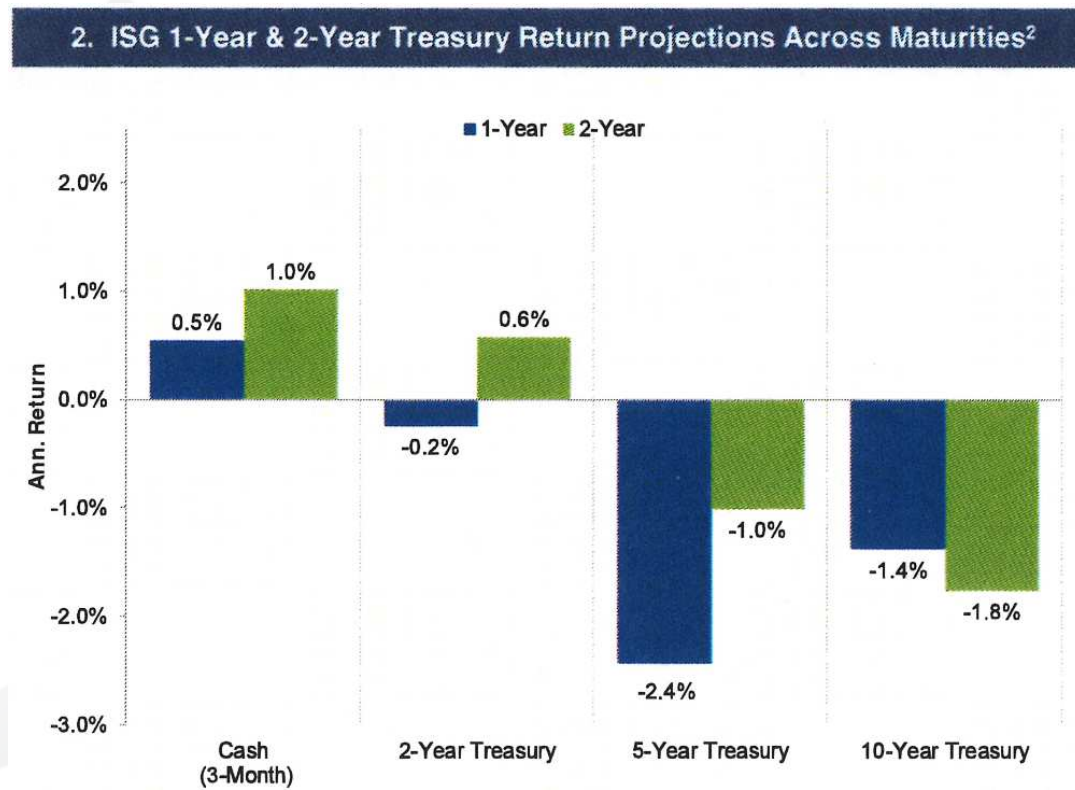
Us Dealer's Inventory & Outstanding U.S. Corporate Bonds

Federal Reserve Bank of NY Primary Dealer Statistics, Net Positions in Corporate Bonds and SIFMA.



Projected returns

- Ⓜ Negative performance projected by GS on 5-year to 10-year US Treasuries



Sample portfolio return

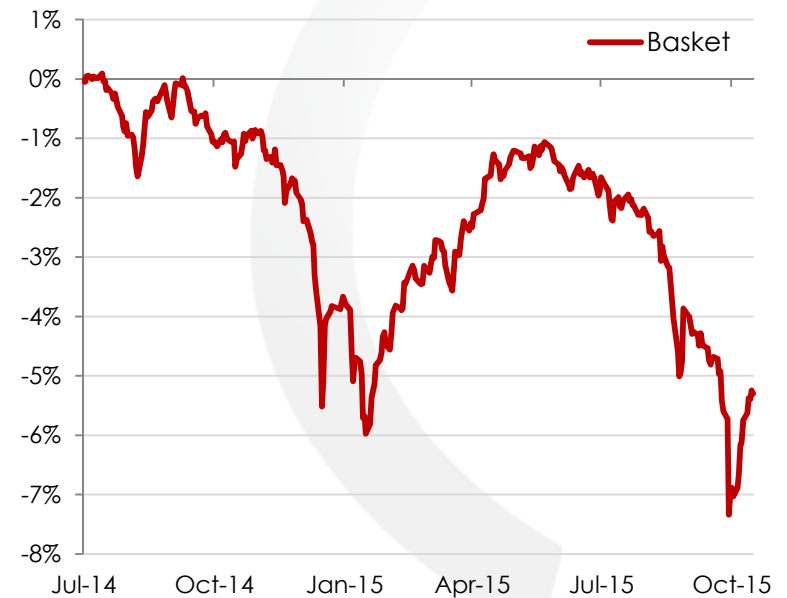
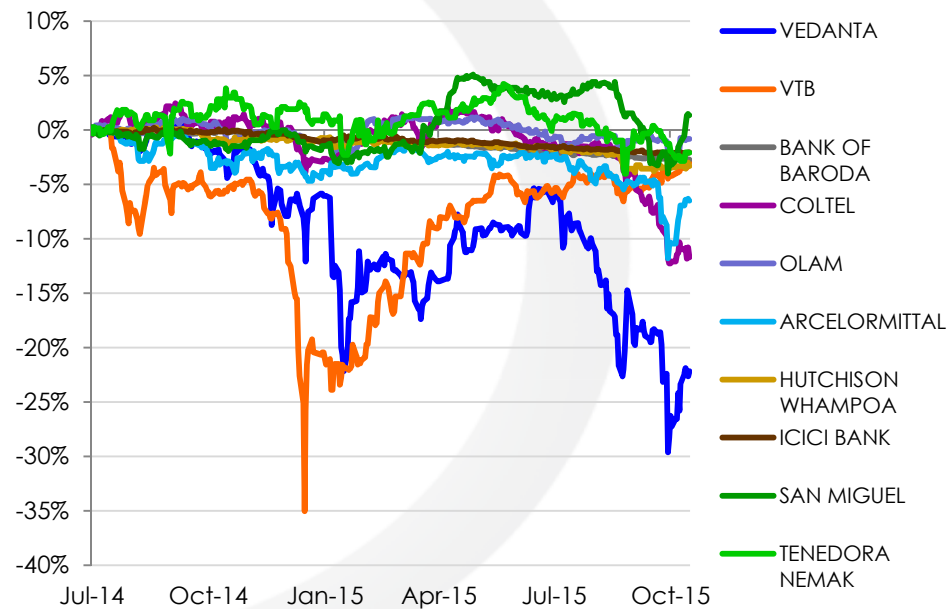
- Buy & hold plain vanilla strategy, medium term duration (circa 3y), BB average credit risk
- Diversification issue with high concentration of risk and low credit quality
- Past 16 months total return positive though: 1.8% gross and 3.5% gross excluding Vedanta, i.e. 2.7% gross annualised unlevered

Issuer	Rating	Coupon	Maturity	Duration	Price 01.07.2014	Price 16.10.2015	P&L	YTM	Earned Coupon	Tot. Ret.
VEDANTA RESOURCES PLC	BB	6	31.01.2019	2.79	104.10	81.00	-22.2%	5.76%	7.55%	-14.6%
VTB BANK JSC	BBB	6.875	29.05.2018	2.32	107.48	104.64	-2.6%	6.40%	8.39%	5.7%
BANK OF BARODA, LONDON BRANCH	BBB-	5	24.08.2016	0.82	105.59	102.71	-2.7%	4.74%	6.21%	3.5%
COLOMBIA TELECOMUNICACIONES S.A. E.S.P. (COLTEL)	BB	5.375	27.09.2022	5.62	100.35	89.01	-11.3%	5.36%	7.02%	-4.3%
OLAM INTERNATIONAL LIMITED	NR	5.75	20.09.2017	1.80	105.23	104.18	-1.0%	5.46%	7.16%	6.2%
ARCELORMITTAL	BB	6.125	01.06.2018	2.34	109.88	102.75	-6.5%	5.57%	7.31%	0.8%
HUTCHISON WHAMPOA INTERNATIONAL 12 LTD	BBB	6	Perp.		107.90	104.40	-3.2%	5.56%	7.29%	4.0%
ICICI BANK LTD, ACTING THROUGH ITS DUBAI BRANCH	BBB-	4.75	25.11.2016	1.05	105.65	103.47	-2.1%	4.50%	5.89%	3.8%
SAN MIGUEL CORPORATION	BB-	4.875	26.04.2023	6.05	94.13	95.15	1.1%	5.18%	6.79%	7.9%
TENEDORA NEMAK, S.A. DE C.V.	BB+	5.5	28.02.2023	5.96	102.24	99.97	-2.2%	5.38%	7.05%	4.8%
Basket	BB	5.625		3.19	104.25	98.73	-5.3%	5.39%	7.07%	1.8%

Sample portfolio return

Ⓜ But a high volatility for bonds and one cannot exclude a casualty such as Vedanta considering low credit quality (BB)

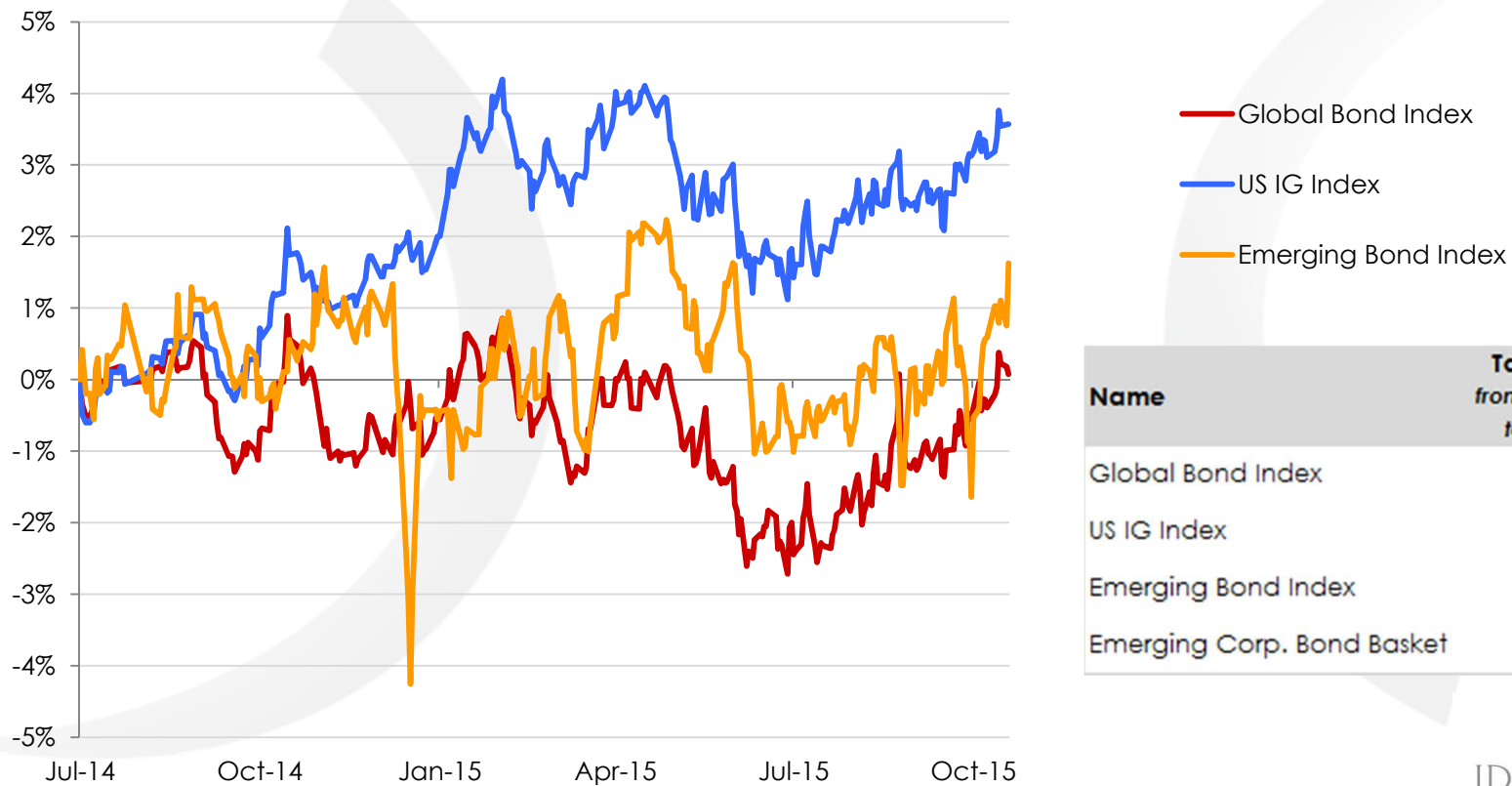
Ⓜ Underlying portfolio is down -5.3% on capital offset by total coupon of 7.1% over 16 months.



Bond index returns

 Global comparative bond indexes have comparable total returns

 Best performers are US IG bonds (about 2.8% gross annualised return)





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