NOMURA ASSET MANAGEMENT U.K. LTD.

US High Yield Bond Fund

Special Update

NOMURA

Considering the credit quality and levels of valuation, where are the investment opportunities in U.S. High Yield?

We expect moderate growth in the U.S. of 1.5% over the next twelve months, while Europe and China also have relatively slow growth. We expect U.S. growth to be driven by a strong U.S. consumer, improved labour markets, and robust growth out of the services portion of the economy. This is offset partially by the roll-off of the fiscal stimulus bill, weakness in the manufacturing segment of the economy, and uncertainties related to trade disputes. We expect the high yield default environment to be relatively benign over the next year. Our default rate expectations over the next twelve months are 2.0% to 2.5%. Given current economic and market conditions, we now expect one additional rate cut by the U.S. Federal Reserve in 2019, while the ECB and other central banks also apply stimulus. Overall, the combination of moderate growth and dovish central banks is positive for high yield. The U.S. high yield market (as measured by the ICE BofAML U.S. High Yield Constrained Index: HUC0) ended August 2019 with a yield-to-worst (YTW) of 5.80% and an option-adjusted spread (OAS) of 380 bps. NCRAM's base case forecast over the next twelve months is for a total return of 5.5% to 6.5%, driven mainly by income generation.

While we are cautious on certain old-economy, commodity, and cyclical sectors that are being impacted by the trade war such as autos, metals and other sectors, the U.S. economy is expected to continue to grow, while low interest rates should continue to support free cash flow generation, debt refinancing activity, and low default rates. To take advantage of the current environment, we have shifted the portfolios towards defensive sectors and higher-quality issuers and increased the overall credit quality of our portfolios. We continue to be overweight the Gaming sector, because of strong consumer trends and a stable U.S. economy. We are overweight the Gas Distribution sector as a core holding, due to high demand for pipelines, their volume-based contracts and the potential for M&A in the sector. We have endeavored to take cyclicality out of our portfolios and we have opportunistically taken down our Energy-Exploration & Production exposure from an overweight to a slight underweight because many shale and oil companies have struggled with production issues. We are also underweight Specialty Retail due to shift to online shopping, and Wireline Telecom due to decline of land-line phones.

"Our fund currently has five Morningstar stars."

MORNINGSTAR ★★★★★ TM

Stephen Kotsen
Fund Manager of the Nomura Funds Ireland US High Yield Bond Fund

"Where are the opportunities in US High Yield."

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