Liontrust GF High Yield Bond Fund

Q3 2023 review

Fund managers: Phil Milburn and Donald Phillips.

The Fund (C5 sterling accumulation class) returned 1.2%* in sterling terms in Q3 2023 while the ICE Bank of America Merrill Lynch Global High Yield Index (GBP hedged) comparator benchmark returned 0.8% and the average return for the IA Sterling High Yield reference sector was 1.4%. The primary B5 US dollar share class returned 1.2%, while the ICE Bank of America Merrill Lynch Global High Yield Index (USD hedged) comparator benchmark returned 0.9% and the average return for the EAA Fund USD High Yield Bond (Morningstar) reference sector was 0.2%.

We also compare the Fund's performance to a leading Global High Yield ETF (seeking to outperform by 1.5% a year)[†]. The Fund's C5 sterling shares class return was ahead of that of the ETF in Q3 and has now outperformed by 2.1 percentage points since inception (June 2018).

The global high yield market returned a positive quarter of 0.90% (USD) in Q3 2023. The US high yield market produced a return of 0.53% (USD) in Q3 2023; in Europe the market returned 2.15% during the period.

The US market saw lower quality bonds outperform higher quality bonds across the last three months with its biggest rally in July. Meanwhile, the European high yield market saw the same pattern, with lower quality bonds outperforming in the quarter, but with the biggest rally from the CCC-rating bucket captured in September. Overall, credits spreads held in well considering the volatile macro backdrop, which is helped by the positive technical of a modest level of primary issuance. The issuance we've seen this quarter have been oversubscribed, priced below the initial price talk and have performed relatively well in the secondary market, given the attractive coupon and quality of issuers. We expect credit spreads to remain range bound until there is evidence of fundamental deterioration. The big theme for credit is high-for-longer policy rates, which creates carry opportunities and medium-term refinancing risk that creates fundamental decompression.

Relative to index, the best performing sectors in the Fund in Q3 2023 were banking and telecommunications. Other strong contributors to stock picking include Altice International (a telecommunications company) where bonds were supported by the news of management issuing a loan to address near-term debt maturities and asset sales in the pipeline; and Ahlstrom (a producer of speciality sustainable materials) which reported earnings that indicated an improvement in margins on the back of a cost-cutting exercise.

We have built up a bit of liquidity in the Fund, just so we are able to take advantage of any stock opportunities during a market wobble. We have cash parked in short-dated US treasuries and have a long risk CDS index overlay in place (selling default protection on the CDX high yield index) to reduce the drag that comes from holding cash, particularly in a higher yielding environment. This has benefited the Fund by 9bps overall.

Areas where our relative underweight position was a drag to performance was in more cyclical sectors, such as energy. This shouldn't come as a surprise as the Fund has a bias towards less cyclical defensive credits. Some of our real estate holdings continue to be a drag, namely CPI Property (CEE office, retail and hotels) and Heimstaden (North European residential). Although operationally these companies have performed well, aided by rent indexation, the corporate bond market has gone on buying strike and their bonds continue to drop. Banks have continued to lend and both of these companies have liquidity at least through 2024 and into 2025, but the bond market has not yet been persuaded. Today these bonds offer great upside, but also continued downside risk if the market for their bonds is not fixed in the next one to two years. Together they represent ~1.5% of the fund.

Note that it’s not been all bad in the real estate sector, for example, Castellum bonds have been very stable and are up over 20% in the YTD, boosted by a rights issue in the equity.

Corporate earnings to date have been mixed but on the whole, in line with expectations provided in the previous quarter. Plenty of credits have mentioned customer destocking as a reason for recent soft quarters, but a turnaround is anticipated in the second half of the year. Earnings for Q3 and Q4 will be interesting in terms of seeing whether a positive turnaround can be achieved for those companies without experiencing further hurdles. Cost cutting is a feature for many and in some cases with companies we are invested in, some have proven their resilience through a turbulent economic environment and have a good enough buffer with respect to margins, liquidity and leverage if the turbulence in the market was to persist. Companies that are of lower quality will find it difficult to perform and refinance upcoming maturities if the current backdrop persists or worsens, in which case we would see an uptick in default rates as a result. We haven’t seen many companies struggling to refinance debt as yet but some definitely have a tough road ahead, while some have been reliant on shareholders’ equity contributions to aid their efforts.

During Q3 2023, the Fund participated in five new issues, one of which was Profine, a refinancing of a bond we owned. The company is a manufacturer of PVC profiles for windows and doors and benefits from the tailwind of energy saving solutions. Profine is a solid credit investment in a good business, with a very healthy balance sheet and expectations of a good 2H 2023 in terms of earnings. The 5 year bonds, rated B2/B, issued in July 2023, came with an attractive coupon of 9.375%, making the investment appealing both from a credit standpoint but also in terms of value.

We participated in TriNet, a leading provider of HR and consultancy services to SMBs (small and medium sized businesses) in the US. The company offers services such as HR expertise, payroll services, benefits, risk mitigation, and compliance. We like this HR outsourcing company due to the structural growth in the sector, a $6 billion market capitalisation and low balance sheet leverage which provides a great cushion for any cyclicality in the business. The deal was USD denominated, rated Ba2/BB, unsecured notes with a 7.125% coupon.

One investment grade purchase in the banking space was of BBVA lower tier 2 debt in GBP. We switched out of our holdings into this new issue. The bond has just over a 10-year maturity and is callable after five years. A credit spread of 360bps, to give a coupon of 8.25%, is very attractive.

Coty is a listed beauty company with a leading brand portfolio across names such as Chloe and Gucci, all the way down to high street names such as Rimmel and Max Factor. The company has been performing well, with a portfolio that has proven resilience during a downturn and generated positive FCF. We like the clear path to deleveraging the balance sheet and see potential for the company to be a “rising star” (get upgraded to investment grade) in a few years’ time. We participated in the 5 year, Ba2/BB+ rated (upgraded by S&P to BB+ from BB since investing) with a coupon of 5.75%.

Lastly, Worldpay was the latest new issue we bought. The company is a global merchant acquirer and payment processor. It benefits from reoccurring, transaction-based revenue, which in combination with strong retention rates, support good future revenue visibility. Ongoing secular trends such as the growth of electronic payments and cash displacement underpin Worldpay's long- term growth potential. We invested in the new 7-year bond in GBP, offering 8.5% coupon – which we think was a steal.

The level of new issues this quarter was relatively lighter than anticipated summer is typically quiet before a surge in issuance over September which really didn’t materialise. The companies that came to market were from higher rated credits, partially demonstrating the appetite for better quality credit among investors but also demonstrating the types of companies that were comfortable enough to refinance in a market where they would be paying a higher interest cost than they were previously on the debt they redeemed. Deals were oversubscribed, showing that there is demand for new issues, IPT (initial price talk) always tightened by 25bps or more once priced – also supporting the level of interest in the primary market. The use of proceeds for most of the deals was for refinancing debt, this quarter the level of secured debt issued was lower than last quarter, overall making it an even split in terms of secured vs. unsecured issues year-to-date.

Outlook

There is market volatility, a 'higher for longer' interest rate environment, and economic data releases showing signs of a slowdown – however, inflation continues to be sticky overall. We are seeing credit spreads holding in well in this environment, with lower-quality bonds outperforming. Part of the reason for this is that BB-rated bonds are typically longer in duration. In the face of a mild recession, which is still our central case, we would expect lower-quality companies to suffer from refinancing difficulties, liquidity buffers being eaten into and cost reductions to only go so far before we start seeing signs of fundamental deterioration. This should result in an increase in default rates.

We are invested in bonds with a high-quality bias, less cyclical and with strong credit metrics to weather a tough economic environment – we believe we are well positioned by making lending decisions based on long-term fundamentals and value, not on short-term market sentiment. The asset class is seeing a re-couponing of the market, where issuers are having to pay a higher coupon to refinance debt previously issued in a low interest rate environment. This in turn means that the running yield on offer is lifted from the higher coupons and provides a significant boost in returns for bond investors in the asset class. The fund is currently offering ~9.2% yield for GBP investors (~7.6% for EUR investors), we view this as highly attractive for investors.

Discrete 12 month performance to last quarter end (%)*:
Past Performance does not predict future returns

	Sep-23	Sep-22	Sep-21	Sep-20	Sep-19
Liontrust GF High Yield Bond C5 Acc GBP	12.5%	-18.0%	10.0%	0.4%	6.6%
ICE BofA Global High Yield Hedge GBP	10.2%	-16.9%	9.8%	1.3%	5.4%
IA Sterling High Yield	10.2%	-14.3%	10.6%	-0.4%	4.7%
Quartile	1	3	3	2	2

*Source: Financial Express, C5 share class, total return, net of fees and interest reinvested. As at 30.09.23. The primary share class for this Fund is in US dollars (B5) but we are showing the C5 sterling-hedged class to compare against the IA Sterling High Yield sector. Discrete data is not available for ten full 12-month periods due to the launch date of the portfolio.

†While the managers of the Fund seek to outperform a leading Global High Yield ETF by 1.5% a year net of fees over rolling three years, this is not a formal objective. There can be no guarantees this will be achieved over the stated time period. The formal objective of the Fund can be found in the Prospectus.

Key Features of the Liontrust GF High Yield Bond Fund

Investment objective & policy[1]	The investment objective of the Fund is to maximise total returns over the long term through a combination of income and capital growth, through investment in the global fixed income market. The Fund invests at least 50% of its assets in high yield bonds (i.e. bonds classified as below investment grade) issued by companies worldwide which are denominated in US Dollar or non-US Dollar bonds that are hedged back into US Dollar. Although the focus is on high yield corporate bonds, the Fund may also invest in investment grade corporate bonds, government bonds, cash or assets that can be turned into cash quickly. The Fund invests in developed and emerging markets, with a maximum of 20% of its net assets invested in emerging markets. Where the Fund invests in non-US Dollar assets, the currency exposure of these investments will generally be hedged back to US Dollar. Up to 5% of the Fund's currency exposure may not be hedged (i.e. the Fund may be exposed to the risks of investing in another currency for up to 5% of its assets).The Fund may invest both directly, and through the use of derivatives. The use of derivatives may generate market leverage (i.e. where the Fund takes market exposure

	in excess of the value of its assets). The Fund has both Hedged and Unhedged share classes available. The Hedged share classes use forward foreign exchange contracts to protect returns in the base currency of the Fund. The fund manager considers environmental, social and governance ("ESG") characteristics of issuers when selecting investments for the Fund.
Recommended investment horizon	5 years or more
Risk profile (SRI)[2]	5
Active/passive investment style	Active
Benchmark	The Fund is considered to be actively managed in reference to the ICE BofAML Global High Yield Hedge USD Index (the "Benchmark") by virtue of the fact that it uses the Benchmark for performance comparison purposes. The Benchmark is not used to define the portfolio composition of the Fund and the Fund may be wholly invested in securities which are not constituents of the Benchmark.
Sustainability profile	The Fund is a financial product subject to Article 8 of the Sustainable Finance Disclosure Regulation (SFDR).

Notes: 1. As specified in the PRIIP KID of the fund; 2. SRI = Summary Risk Indicator. Please refer to the PRIIP KID for further detail on how this is calculated.

For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/glossary

Key Risks:

Past performance does not predict future returns. You may get back less than you originally invested. We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

- The fund manager considers environmental, social and governance ("ESG") characteristics of issuers when selecting investments for the Fund.
- Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result;
- The creditworthiness of a bond issuer may also affect that bond's value. Low rated (high yield) or equivalent unrated debt securities of the type in which the Fund will invest generally offer a higher return than higher rated debt securities, but also are subject to greater risks that the issuer will default. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to
- pay.
- Overseas investments may carry a higher currency risk. They are valued by reference to their local currency which may move up or down when compared to the currency of the Fund.
- The Fund can invest in derivatives. Derivatives are used to protect against currency, credit or interest rate moves or for investment purposes. There is a risk that losses could be made on derivative positions or that the counterparties could fail to complete on transactions.
- The Fund uses derivative instruments that may result in higher cash levels. Cash may be deposited with several credit counterparties (e.g. international banks) or in short dated bonds. A credit risk arises should one or more of these counterparties be unable to return the deposited cash.
- The Fund invests in emerging markets which carries a higher risk than investment in more developed countries. This may result in higher volatility and larger drops in the value of the fund over the short term.
- The Fund may encounter liquidity constraints from time to time. Participation rates on advertised volumes could fall reflecting the less liquid nature of the current market conditions.
- Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

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