



Quarterly Report

Fourth quarter 2018

Nordea 1 – US Corporate Bond Fund

ISIN: LU0458979746 (BP-USD)

Overview

- US corporate spreads widened 48 bps to 153 bps on the back of growing macro concerns¹
- Poor market technicals, including reduced liquidity, amplified price swings
- Higher quality bonds outperformed due to the flight-to-safety behaviour

1) Sources: Nordea Investment Funds S.A. and Bloomberg Barclays. Period under consideration: 30.09.2018 – 31.12.2018. The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.

Investment strategy

The fund seeks to achieve consistent, superior rates of return with low volatility by investing primarily in debt securities rated BBB– or better by S&P or Baa3 or better by Moody's at purchase. The fund manager uses a top-down analysis to exploit opportunities and neutralize unwanted risks, and a bottom-up analysis to maximize total return. The fund manager protects the downside by understanding the risk exposures within the portfolio and the correlation among assets, by diversifying risk factors, by defining/articulating an exit strategy for each position, and by carefully monitoring expected tracking error.

Fund data

Share class	BP-USD
Fund category	Accumulating
NAV in USD	14.02
Base Currency	USD
Fund AUM Million (USD)	2,319.99
Front end fee in %	Up to 3.00
Annual management fee in %	0.70
Launch date	14.01.2010
ISIN	LU0458979746
Sedol	B3MMLR8
WKN	A0YKE1
Bloomberg ticker	NORBPUS LX
No. of holdings	347
Swing factor / Threshold	Yes/Yes

Data as of 31.12.2018.

Portfolio Managers

MacKay Shields LLC



Shu-Yang Tan, CFA
Portfolio Manager

Quarterly commentary Q4 2018

US Treasuries rallied significantly in the fourth quarter while both credit and equity investments sold off on fears of weaker global growth in China, Japan and the European Union, restrictive US Fed policy and the US administration's public criticism of the Fed, trade wars with China, Brexit negotiation uncertainty, mid-term elections and the potential for a government shutdown.

The benchmark 10-year Treasury rate fell nearly 60 bps from its mid-November high to close the year at 2.65%. More disconcerting was the inversion of the front-end of the yield curve during the quarter, as measured between 2-year and 5-year maturities. Although the inversion appeared to be driven by strong technical considerations associated with a flight-to-quality, it is worth noting that an inverted curve has been historically a strong indicator of an economic slowdown.

As expected, the FOMC committee raised the target Fed Funds rate 25 bps in December to 2.25 – 2.50%. This marked the ninth rate hike dating back to December 2015. The decision to raise rates followed a series of mixed comments from Jerome Powell given at two different events during the quarter. During an interview in October, Powell communicated that interest rates were "a long way" from neutral, and in November at the Economic Club of New York he stated that interest rates were "just below" the range for the neutral rate. Additionally, commentary from various Fed governors created further ambiguity rather than transparency, thus contributing to the bout of market volatility in asset prices.

During the quarter the Fed accelerated its quantitative tightening approach, or balance sheet reduction of US Treasuries and mortgage-backed securities from USD25 billion per month to USD50 billion.

The fund returned -0.78% during Q4 while its benchmark, the Bloomberg Barclays Capital US Credit Index, returned -0.22%.²

Although we reduced risk in the strategy over the last 12 to 24 months given full valuations, tighter monetary conditions and increased idiosyncratic risk, the fund remained vulnerable to the strong technical in the market. We focused on shortening spread duration, moving up in the capital structure, investing in secured deals for better protection and reducing highly levered, deteriorating credit profiles.

Investment grade corporate spreads, as measured by the Bloomberg Barclays US Corporate Index widened 48 bps to 153 bps at quarter-end. Much of the spread widening can be attributed to poor market technicals, including reduced liquidity that amplified price swings. Additionally, heavy supply, headwinds from FX hedging costs from foreign buyers and reduced demand also played a role. In our view, idiosyncratic risk is much more prevalent in the market today, as we have

seen with names such as General Electric and the US auto manufacturers. During the quarter, the commodity sectors including energy and metals & mining lagged the overall market, as did autos, life insurance and subordinated positions of banks. Alternatively, non-cyclical defensive sectors such as wireless, consumer products, healthcare and utilities fared much better. Lower quality BBB rated credits underperformed higher quality credits and longer maturities underperformed shorter maturities.

It's worth noting that high yield spreads, as measured by the Bloomberg Barclays US High Yield Index widened 210 bps to 526 bps during the quarter, bringing the overall market yield to approximately 8%. In percentage terms, the high yield market returned -4.5% over the reporting period. Energy proved to be the weakest performing segment of the market as oil prices declined sharply. Wirelines, retail and basic industry also lagged the overall market, while capital goods, gaming and lodging were among the better performers.

At the portfolio level, duration and yield curve positioning detracted from results during the quarter, as did the off-benchmark allocation to BB rated credits. The lack of exposure to emerging market credit held in the benchmark provided some offset, but not sufficiently. At an industry level, energy, banking, and consumer cyclicals weighed on results within the investment grade market while relative positioning in capital goods, retail and utilities contributed to results.

As we begin a new year, we need to acknowledge both the headwinds and tailwinds facing the markets. In terms of the positives; US economic activity is healthy and inflation is still relatively tame, the consumer is in strong financial condition, the Federal Reserve plans to be "patient" and asset prices are cheaper, and in some cases, more attractive as a result of the recent volatility. Although we believe the volatility is unlikely to recede anytime soon, economic conditions still remain supportive and the current environment has provided opportunities for relative value consideration.

Some of the reasons for caution include tighter monetary conditions in the US coupled with a flat/inverted curve, fading fiscal stimulus, a crisis of confidence building due to Brexit, trade wars and populist elections, and elevated corporate leverage. While we acknowledge that it can be difficult to predict the beginning of the next economic downturn with any degree of precision, it is critically important to be sufficiently early. Accordingly, we believe caution is warranted as we navigate the markets in the new year. The Federal Reserve has embarked on a path of policy normalization for the past three years and they are unlikely to change course in 2019. The Fed may or may not elect to "pause" at some point during the year, but it is important to keep in mind that the reduction of the central bank's balance sheet will continue to restrict credit growth in the US. Vigilance and active management will become increasingly important.

Cumulative returns as of 31.12.2018 in %

Time frame	Fund ³	Index ⁴
Year to date	-3.74	-2.34
1 month	0.87	1.27
3 months	-0.78	-0.22
6 months	0.00	0.67
1 year	-3.74	-2.34
3 years	7.00	9.53
5 years	9.79	16.87
Since launch	39.10	45.39

Calendar year returns in %

Time frame	Fund ³	Index ⁴
2017	6.02	6.18
2016	4.85	5.63
2015	-2.55	-0.77
2014	5.29	7.53
2013	-0.63	-2.03

Performance of the fund versus reference index (since inception on 14.01.2010)



3) ISIN Code LU0458979746. Inception date: 14.01.2010. 4) Bloomberg Barclays Capital US Credit Index. Source: Nordea Investment Funds S.A. Period under consideration: 14.01.2010–31.12.2018. The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested.

Top ten holdings as of 31.12.2018 in %

Company	ISIN Code	Weight
United States Treasury Bill 10-01-2019	US912796QS12	4.31
Evergy Inc 4.85% 01-06-2021	US391164AE09	1.22
Morgan Stanley 4.875% 01-11-2022	US6174824M37	1.21
Hewlett Packard Enterprise C 3.6% 15-10-2020	US42824CAG42	0.85
Huntington Bancshares Inc/OH 7% 15-12-2020	US446150AG96	0.85
United Airlines 2014-1 Class 4% 11-04-2026	US90932PAA66	0.83
General Motors Financial Co 3.45% 10-04-2022	US37045XAW65	0.80
Puget Energy Inc 5.625% 15-07-2022	US745310AF99	0.76
Goldman Sachs Group Inc/The 5.75% 24-01-2022	US38141GGS75	0.73
Bank of America Corp 3.004% MULTI 20-12-2023	US06051GHC69	0.72

Source: Nordea Investment Funds S.A. Date: 31.12.2018.

Rating breakdown as of 31.12.2018 in %

Rating	Fund	Index ⁵
AAA	0.93	8.49
AA	10.68	8.25
A	17.74	30.79
BBB	63.85	49.44
BB	3.36	3.04
B	0.00	0.00
CCC and < CCC	0.00	0.00
NR	0.00	0.00
Net liquid assets	3.44	0.00

5) Bloomberg Barclays Capital US Credit Index. Source: Nordea Investment Funds S.A. Date: 31.12.2018.

Asset allocation as of 31.12.2018 in %



Source: Nordea Investment Funds S.A. Date 31.12.2018.

Maturity breakdown as of 31.12.2018 in %

Years	Fund
0–1	9.71
1–3	13.96
3–5	19.95
5–7	15.05
7–10	13.35
10–15	2.28
>15	22.25
Net liquid assets	3.45

Source: Nordea Investment Funds S.A. Date: 31.12.2018.

Risk figures as of 31.12.2018

	Fund	Index ⁵
Yield to worst	4.25%	4.09%
Effective duration	6.58	6.85
Average rating	BBB+	A

5) Bloomberg Barclays Capital US Credit Index. Sources: Nordea Investment Funds S.A. and MacKay Shields LLC. Date: 31.12.2018.

Treasury Future Exposure as of 31.12.2018 in %

US 2YR NOTE (CBT) 3/2019	12.03
US 10yr Ultra Fut 3/2019	4.43
US ULTRA BOND CBT 3/2019	2.54
US LONG BOND(CBT) 3/2019	1.71
US 5YR NOTE (CBT)3/2019	-2.92
US 10YR NOTE (CBT) 3/2019	-5.91

Source: Nordea Investment Funds S.A. Date: 31.12.2018.

Source (unless otherwise stated): Nordea Investment Funds S.A. Period under consideration (unless otherwise stated): 30.09.2018–31.12.2018. Performance calculated NAV to NAV (net of fees and Luxembourg taxes) in the currency of the respective share class, gross income and dividends reinvested, excluding initial and exit charges as per 31.12.2018. Initial and exit charges could affect the value of the performance. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of shares can greatly fluctuate as a result of the sub-fund's investment policy and cannot be ensured.** If the currency of the respective share class differs from the currency of the country where the investor resides the represented performance might vary due to currency fluctuations. 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