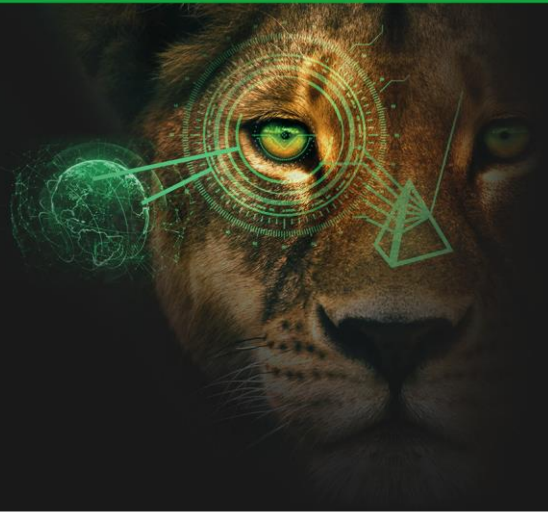

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Global Fixed Income

Q1 2024 Review

Liontrust GF High Yield Bond Fund

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The Fund (C5 sterling accumulation class) returned 2.7%* in sterling terms in Q1 2024 while the ICE Bank of America Merrill Lynch Global High Yield Index (GBP hedged) comparator benchmark returned 2.9% and the average return for the IA Sterling High Yield reference sector was 2.0%. The primary B5 US dollar share class returned 2.7%, while the ICE Bank of America Merrill Lynch Global High Yield Index (USD hedged) comparator benchmark returned 2.0% and the average return for the EAA Fund USD High Yield Bond (Morningstar) reference sector was 1.2%.

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 slightly ahead of that of the ETF in Q1 and has now outperformed by around five percentage points since inception (June 2018).

The global high yield (HY) market returned a positive quarter of +0.9% (USD) in Q1 2024, taking the full year 2023 return to +12.9%, a complete turnaround from last year's negative return (-11.4%). The US HY market produced a return of 0.3% (USD) in Q1 2024; in Europe the market returned 1.4% during the period.

Both markets performed well primarily on the back of expectations that rate cuts are on the horizon amid easing inflation concerns, while the Federal Reserve embraced a 'lower, sooner' narrative at its December meeting. These developments led the market to price rate cuts in the early part of 2024, with the 'peak rates' narrative this resulted in boosting performance in risk assets.

The US and European HY markets in Q1 both saw CCC bonds outperform BB and B bonds, in particular in Europe. A lot of the better-quality credits in the asset class are trading with a tight spread; investors are looking for pockets of value across bonds, some further down the capital structure, further down the ratings spectrum or across sectors that have previously been unloved.

Demand for new issues is resilient, bonds are tightening well inside IPT (Initial Price Talk) and often leave minimal premium to the secondary market, but access to the market has predominantly been from better quality issuers. We are likely to see the uptick in primary over the next quarter.

We have not seen issuance from lower-quality companies, mainly because of the high coupon that would be required to get a deal done at the expense to issuers who may not have the best free cash flow profile to deal with an increase in interest costs. These companies are having to seek alternative financing. However, we have seen a few headlines this quarter from companies that have a good business but also have 2025 maturities to address. In these cases, where accessing the bond market doesn't look feasible they are having to seek advice from debt advisors about restructuring their debt.

Fund performance

Relative to index, the best performing sectors in the Fund during Q1 2024 were real estate, insurance and basic industry. Real estate in particular has seen a strong turnaround year-to-date, supported by market expectations of rate cuts on the horizon and also by being one of the few sectors looking attractive from a valuation standpoint. This sector was previously a drag to performance, but we expect the positive turnaround to persevere. Among the strong stock picking contributors was CPI Properties (office, retail and hotels in central & eastern Europe). The bonds benefited from positive headlines around asset disposals and also from news that the company is in talks with private equity Apollo about a €450 million investment.

This quarter, the healthcare and capital goods sectors were a drag on performance, but mainly for idiosyncratic reasons. Grifols (a Spanish plasma therapeutics company) has upcoming 2025 maturities to address which it intends to do so from a mixture of asset sale proceeds (due to complete H1 2024) and cash. The bonds experienced some volatility relating to a short-seller note from Gotham City questioning the company's financial accounting, which the company and Spanish regulators later addressed. Rating downgrades mainly cite the risks around the success of the asset stake sale and proceeds coming through, which in turn would be a risk for the company of not being in a position to address upcoming maturities. We believe we have right-sized our exposure considering the risks, and expect the asset sale to successfully go through. Management have formally said how they wish to use the proceeds for debt reduction explicitly, the rating agencies are now waiting to conclude their review on the back of the anticipated debt reduction.

Ardagh, an Irish glass and metal packaging company, is well known within the HY market. Operationally, it has been impacted by volume declines due to customer de-stocking and isolated issues related to one of its key customers. It too, like Grifols, has 2025 maturities to address and had plenty of liquidity to get through 2025 needs, but a headline regarding the company's intention to seek debt restructuring advice saw the bonds react negatively. We sold out of our modest position on the back of the headline. A company like Ardagh has a good business but too much debt on its balance sheet to navigate the current environment, where access to the markets requires issuers to pay a substantial coupon.

Trade activity

During Q1 2024, we participated in five new issues. We participated in Pinewood (BB+/BBB-), a leading independent provider of infrastructure required to produce film and TV content. We liked the fact the credit is supported by rents that are mostly long-term and RPI linked. The company has recently expanded out its sites and have pre-let most of the expansion before completion, indicating the level of demand for space, alongside the positive demand for online streaming provides a good tailwind for the credit. Interest costs will increase on the back of this refinancing but it will be manageable and the expected increase in EBITDA should offset this. The company offered a six year, £500 million note with a 6% coupon. Although it came at the tighter end of guidance, for a highly rated company with a solid credit profile, we thought it justified a tighter spread.

FirstCash is a company we already had exposure to via the unsecured 4.625% $ 2028 notes, a company that owns and operates pawn stores in North and Central America. It came to market with a 2032 bond with a 6.875% coupon, for a Ba2/BB rated credit. We thought the pricing was attractive and participated in the deal.

Q-park is one of the leading off-street parking infrastructure owners and operators in Western Europe, and came to the market to refinance upcoming maturities. We liked the strong business model, ability to pass on inflationary linked costs to customers and strong operating track record, mainly supported by the company's ability to increase tariffs. The new euro issue is rated B1/BB- and came with a 5.125% coupon.

We participated in Ardonagh, an insurance broker, carrying out both property and casualty insurance distribution and specialty insurance broking. We like the structural growth in the end markets, low cyclicality of the industry, capital-light business model, and high customer retention rates. As Ardonagh expands, the company is moving up the value chain to start to look more like a European version of Marsh or Aon. Net leverage is high at 5.5 times, and that's using pro forma EBITDA figures as opposed to reported ones, but the company has the ability to deleverage using cash flow by about 0.5 times per annum. The secured euro denominated bonds purchased are rated B-/B with a coupon of 6.875%, giving a credit spread of about 475 basis points.

Finally, we also purchased debt issued by Kier, a construction company with a large proportion of revenue from public sector contracts. While the construction sector itself is highly cyclical, the long-term contracts that Kier has create great revenue visibility which is an attribute that we value highly in a bond issuer. Kier had a chequered past – it undertook a rescue rights issue five years ago and the new management has turned the company around and de-risked the contracts. The balance sheet has also improved and is forecast to continue to do so, resulting in a broad credit rating of BB (BB- at S&P, BB+ at Fitch). We are attracted to the revenue visibility and continued credit improvement story, and with a yield of 9% for 5-year sterling bonds we think this is an attractive opportunity.

Outlook

The prospect for interest rate cuts is driving the rally and performance in risk assets. We anticipate a mild recession along with rate cuts. Credit spreads remain tight but we are starting to see some idiosyncratic issues in the HY market, with the likes of Altice France, Ardagh Packaging and Intrum seeking debt restructuring advice. A lot of these credits would previously have accessed the bond market fairly easily to address upcoming maturities but as the current market environment requires issuers to pay a sizeable coupon to issue a bond and get a deal done, some credits are being forced to look at alternative financing and some, as mentioned, are having to explore restructuring their debt.

We expect credit spreads to remain tight until there is further evidence of fundamental deterioration among credits. We anticipate more companies to suffer from refinancing difficulties, especially with the 2025/26 debt maturity walls that investors are concerned about. The higher coupon needed to issue a bond will be a burden on free cashflow generation for those companies that are able to access the market, and liquidity buffers will be impacted as well as leverage increasing. These factors should lead us to see higher default rates (from a low base) in the asset class over the remainder of the year and a wider dispersion of credit spreads from higher quality credits to lower quality ones.

The Fund continues to invest in bonds based on strong corporate fundamentals and has a bias towards high quality defensive credits, with minimal exposure to cyclical credits. We believe our defensive approach stands us in good shape to perform if and when default risk is the major driver of the market, rather than interest rates. The Fund is currently offering ~9.15% yield for GBP investors (~7.56% for EUR investors), which we view as an attractive entry point for clients.

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Discrete years' performance (%) to previous quarter-end:

	Mar-24	Mar-23	Mar-22	Mar-21	Mar-20
Liontrust GF High Yield Bond C5 Acc GBP	12.9%	-6.4%	-1.7%	24.0%	-9.1%
ICE BofA Global High Yield Hedge GBP	10.8%	-4.7%	-3.5%	23.3%	-9.3%
IA Sterling High Yield	10.8%	-4.5%	-1.1%	23.5%	-10.0%
Quartile	1	4	3	2	2

*Source: Financial Express, C5 share class, total return, net of fees and interest reinvested. As at 31.03.24. 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.

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

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.

Disclaimer