Nordea
ASSET MANAGEMENT

Fund Portrait

Risk and reward profile

1	2	3	4	5	6	7

Lower risk — Higher risk

Typically lower rewards — Typically higher rewards

Second quarter 2020

Nordea 1 – European Cross Credit Fund

ISIN: LU0733673288 (BP-EUR) / LU0733672124 (BI-EUR)

Highlights

- Play the crossover universe of High Yield and Investment Grade bonds to take advantage of structural inefficiencies created by rating agencies
- European credit fund investing in the BBB+ to B– categories (ex-financials)
- Bottom-up driven approach ensuring that only bonds of companies with solid fundamentals are selected
- Aims to yield more than an Investment Grade portfolio with a lower risk than a "pure" High Yield one
- Hedged in Euro

Asset Management at Nordea

As an active investment manager, Nordea Asset Management manages asset classes across the full investment spectrum and aims to serve its clients in every market condition. Nordea's success is based on a sustainable and unique multi-boutique approach that combines the expertise of specialized internal boutiques with exclusive external competences allowing us to deliver alpha in a stable way for the benefit of our clients. Furthermore, we've put a lot of emphasis on launching outcome – as opposed to benchmark – oriented investment solutions whose basis, "stability investment philosophy", is designed to meet clients' risk appetite and needs.

The Nordea 1 – European Cross Credit Fund has been managed internally by the Credit Team since launch 22.02.2012. The investment team is located in Copenhagen and comprises 16 experienced portfolio managers and analysts organized by industry. At least 2 analysts follow the same industry, covering the entire risk spectrum from investment grade (IG) to high yield (HY). This ensures a full visibility of the entire market and allows playing the crossover universe. The team manages a number of products in the credit space ranging from money market to high yield solutions and is responsible for more than 16 bn Euro[1].

The "crossover" investment universe

Since their creation at the beginning of the last century, **rating agencies** have continuously gained a growing influence on the assessment of debt obligation issuers and the debt instruments themselves. Ratings have become the foundation of credit risk evaluation, private contracts, investment guidelines and some financial regulations.

	Credit Risk	Standard & Poor's	
Investment grade	Highest quality	AAA	
Investment grade	High quality (very strong)	AA	
Investment grade	Upper medium grade (strong)	A	
Investment grade	Medium grade	BBB	Crossover space
High Yield	Lower medium grade (somewhat speculative)	BB	Crossover space
High Yield	Low grade (speculative)	B	
High Yield	Poor quality (may default)	CCC	
High Yield	Most speculative	CC	
High Yield	No interest being paid or bankruptcy petition filed	C	
High Yield	In default	D	

Source: Standard & Poor's.

While ranking bonds across the risk spectrum, rating agencies have created **two main corporate bond categories: Investment Grade (IG) and High Yield (HY).** This has led to a segmentation where investors typically don't cross the barrier of quality between BBB investment grades and high yield bonds with a rating of BB and below. This distinction, based on an arbitrary barrier set by rating agencies, creates inefficiencies and a new world of opportunities: the **crossover space.**

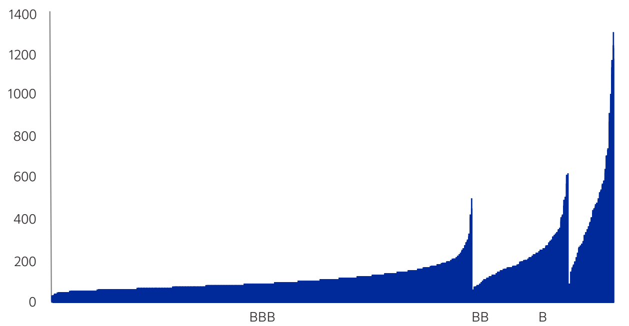
Bonds that occupy the space on the risk spectrum where IG meets HY and straddle the gap between both segments are called **crossover bonds.** They include the lowest-rated investment-grade bonds (e.g. BBB by S&P) to the highest-rated high-yield bonds (e.g. BB by S&P).

1) Source: Nordea Investment Management AB. Date: 30.06.2020.

Exploiting market inefficiencies

Bond ratings are intended to make markets more efficient by reducing information costs for investors and creditors. Nevertheless, at times, the market can disagree with the rating agencies classification. We have already seen investors starting to consider certain BBB rated credits as HY bonds, as witnessed by spikes in **credit spreads,** while the rating agency still stick to the old rating of BBB (see table below).

Credit spread distribution on rating classes



Source: Nordea Investment Management AB based on index data from BofA Merrill Lynch as of 31.12.2019. Financial issuers are excluded from the data. Note: The bar chart shows bonds within the respective rating class sorted by credit spread level (basis points).

These market imperfections cause pricing discrepancies and open up investment opportunities, especially at the borderline rating scheme between IG and HY.

How to capitalise on these opportunities?

By adhering to the prevalent practice of separating their investment grade and high yield mandates, investors may be limiting their opportunities to benefit from corporate credit allocations. To gain from the opportunities that both of these worlds offer, Nordea has launched a dedicated strategy focused on crossover bonds.

The **Nordea 1 – European Cross Credit Fund** exploits investment opportunities across what we call 6B's: BBB, BB and B rating categories. The cornerstone of the strategy is **to exploit credit spreads/valuation variations between the different rating buckets** revealing the best risk/adjusted returns. Consequently, the Portfolio Manager selects the credits with the healthiest fundamentals within this specific universe at an attractive relative valuation.

This **bottom-up approach** results in a conservative high conviction portfolio being built based on the credits' solid fundamentals. Furthermore, in order to be less dependent on short-term political and macroeconomic developments as well as related volatility, the fund doesn't have any exposure to financials (no banking and insurance).

A specific characteristic of investing across the crossover space is that the fund could **catch the most attractive fallen angels and pick rising stars.** The change in a credit spread following a change in a company's fundamental is immediate while a re-rating by rating agencies often tends to lag. As a result, pricing discrepancies occur and opportunities arise.

Fallen angels

When a company is downgraded from investment grade to high yield and becomes a fallen angel, its bonds generally lose value – in part because some investors may be forced to sell their holdings in the company for regulatory purposes. This may lead to mispricings and can create opportunities to buy relatively strong debt at discounted prices.

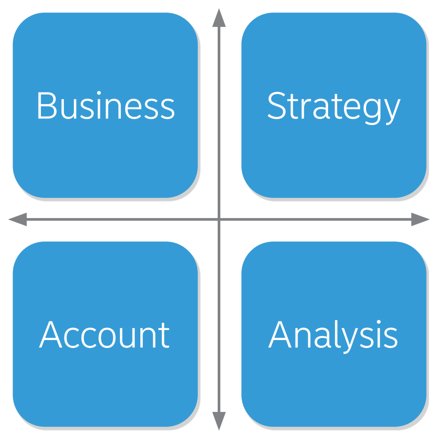
Rising stars

When a company is upgraded from high yield to investment grade, bondholders will generally see the value of their bonds appreciate as investors recognize the improved corporate fundamentals.

The fund will **NOT ONLY** invest in fallen angels and rising stars. By a continuous focus on relative value in the crossover universe we will catch attractive opportunities when they arise.

Focus on bottom-up selection

The primary focus is to assess long-term developments that will impact the credit profile of an issuer. The analysis consistently runs through 4 categories of credit considerations as shown in the graph below.



- **Business** refers to industry dynamics, position of company, substitutes/technology, profit drivers, growth drivers and regulatory risk. We do not like low visibility, aggressive market share competitions, LBO risk and regulatory risk

- **Strategy** is analysed in terms of business strategy, communication, disclosure and financing strategy. We look for consistency in strategy, reporting and communication, commitment to rating target, targeted use of capital in order to implement appropriate capital structure. We do not like aggressive growth targets, acquisition based growth strategies, off balance sheet risk, excessive shareholder value focus and expansion into unrelated business areas

- **Account** is about relevant financial ratios. In evaluating a given issuer we monitor and evaluate the current quarterly results, but our focus is on identifying medium to long term structural changes critical to credit quality. We generally look for stable cash flow, operating efficiency and diversification and perform scenario analysis to evaluate sensitivity towards business relevant risks

- **Structure** is the debt profile, position in capital structure, covenants and legal structure. We look for diversified debt maturity profiles, back up facilities, covenants and transparent company structure

The Portfolio Manager bases his portfolio construction decisions on the credit analysis input from our sector analysts. The sector specialist would express their highest convictions within their respective sectors and consistently rank bonds on credit fundamentals and relative value regardless of ratings. Based on these ranked lists the Portfolio Manager will select bonds across sectors and position the portfolio to be within the investment guidelines and according to the targeted volatility band (±2%) between investment grade and high yield indexes (both ex-financials). The aim is to have a certain level of risk measured as expected volatility.

With a non-official benchmark, the direct implication is that the Nordea 1 – European Cross Credit Fund does not have to consider relative issuer and sector exposures. This is further supported by the fact that the reference index, which is used to control volatility, is not investable. This implicates that only bonds considered to possess strong fundamental characteristics and relative value find the way into the portfolio. As a result the portfolio construction process is simple and bonds in the portfolio are initially equally weighted.

Financials are excluded from the investable universe, as financials are considered to be driven by short term drivers or themes – currently related to regulatory changes. This makes Financials unsuitable for long-term buy and hold investment, which is the basis for our crossover strategy. With the high transaction costs in the credit markets, it is intended to reduce portfolio turnover rate via a defensive selection approach with the initial aim to keep bonds until maturity.

The Portfolio Manager focuses on exploiting the full risk budget on the key expertise of the team, namely fundamental credit analysis, and do not use a top-down investment approach.

Jan Sørensen, Portfolio Manager of the Nordea 1 – European Cross Credit Fund.

"Only the total portfolio risk is to be considered and only securities with high convictions find their way to the portfolio – either we like the credit fundamentals or not.

Keep it simple: a truly defensive high yield

Total return strategy:

- No benchmark – target a risk level between IG and HY European cash bonds, ex. Financials
- Conservative high conviction security selection

Targets 50 – 70 issuers:

- Fixed and floating rate notes
- Only invest in BBB to B ratings at time of purchase
- Max 10% non-rated bonds
- Max 5% per issuer
- Corporate issuers only, no financials (no banking and insurance companies)

Buy & Hold approach:

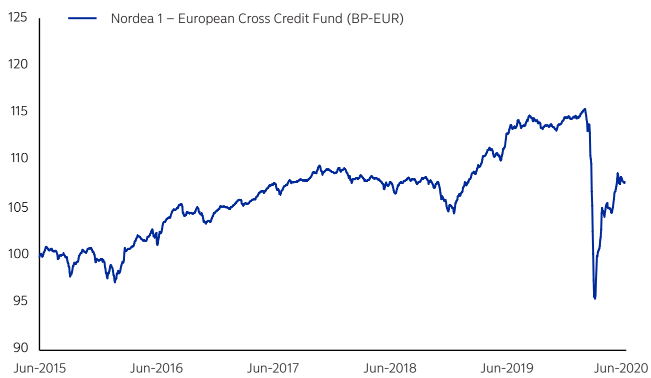
- Defensive selection approach based on bottom-up credit analysis and hold to maturity
- Low trading costs

Cumulative returns in % (30.06.2020)	Fund[2]
YTD	–5.89
1 month	0.90
3 months	7.33
6 months	–5.89
1 year	–4.63
3 years	0.77
5 years	7.87
Since launch (22.02.2012)	28.01

Calendar year returns in %	Fund[2]
2019	9.01
2018	–3.43
2017	3.67

Nordea 1 – European Cross Credit Fund	
Fund manager	Nordea Credit Team
Fund domicile	Luxembourg
ISIN codes*	LU0733673288 (BP-EUR) LU0733672124 (BI-EUR)[3]
Annual management fees	1.00% p.a. (BP-EUR) 0.50% p.a. (BI-EUR)[3]
Base currency	EUR
Fund size in millions	1,239.76
No. of holdings	94
Launch date	22.02.2012

Performance (30.06.2015 – 30.06.2020)



Risks

Please be aware that there are risks associated with investing in this sub-fund, amongst others in: **ABS/MBS, Credit, Derivatives, Hedging, Prepayment and extension.** For further details, please refer to the Key Investor Information Document, which is available as described in the disclaimer at the end of this document.

*Other share classes may be available in your jurisdiction. 2) BP-EUR share class. 3) BI-EUR share class: only for distribution towards institutional clients. Minimum investment amount: EUR 75,000 (or the equivalent).

Source (unless otherwise stated): Nordea Investment Funds S.A. Period under consideration (unless otherwise stated): 22.02.2012 – 30.06.2020. 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 30.06.2020. 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, you could lose some or all of your invested money.** 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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