BrightGate Capital, SGIIC
c/ Génova, 11 – 28004 Madrid
Tel. +34 91 441 0011
www.brightgatecapital.com

I would like to start with a basic overview of the Fund. The evolution of the NAV was 110.65 at 31st of December 2016, with an annual return of 4.28%. The fund was originated the 14th of October 2013 and return since inception has been 10.65%. The ISIN code for the fund is LU0942882589.

2016 has been a very volatile year in the High Yield market. Despite the environment, **we delivered a healthy +4.28% at the end of the year**. As we always say, the Buy & Hold nature of our strategy, with a defined maturity and globally diversified, does not make easy to benchmark our fund against an index – nor is the aim of the Manager and our investors. However, we consider important to provide some reference point. The index that tracks closely our strategy is the Bloomberg Global High Yield 1-5 Corporate Bond Index, which closed the year with a performance of 13.15%, mainly due to its overweight to energy and materials, two sectors that suffered badly at the beginning of the year but that have rallied since then. Going forward, we will strive to keep delivering higher returns with lower volatility than the index to our investors over a full credit cycle. Although we have underperformed the Index in 2016 (overperform since inception with all years in positive) we have experienced a much lower volatility. **Standard deviation of the fund during 2016 has been 1.45% well below the 5.10% of the Index. Sharpe Ratio in 2016 is 3.06%.** Sharpe Ratio measures the excess of performance with respect to the risk-free rate (in our case Euribor 3 month) per unit of volatility over the time frame (1 year).

Now I will continue with the relevant events during the year. The beginning of the year saw a rout in global indices, but especially in commodity markets. The BOFA Merrill Lynch decline -5.1% just in the first two months of the year and the supply of fallen angels (i.e. a company that was investment grade but that has been later reduced to high yield status) was unusually high. Since February, as worries about China's economic situation faded away (see below), the outlook for commodities improved markedly and the main high yield indices rallied accordingly.

Two political events have been the main sentiment drivers in 2016: Brexit in June and Trump's victory in the US presidential election in November. Whereas Brexit's impact on the markets (currency issues aside) was short-lived, Trump's victory has brought optimism to the markets (US equity indices reached new highs and commodities rallied even more), promising to make "America great again". That fact, coupled with the second-rate hike by the FED in December, has strengthened further the dollar. Although Trump has not unveiled much of his program in detail yet, and we do not know how many hurdles he will find in the Congress to pass some of his measures, we believe that the recent optimism is unwarranted. Trump's investment program (if it's finally carried out) will put an enormous pressure on the US balance of payments, which has been suffering lately because of the strong dollar and the disappointing growth performance of many of its main trading partners. The US trade balance of goods and services (exports of goods and services minus imports) reached a deficit similar in absolute magnitude to the one saw in 2006, showing that it will difficult to make American manufacturing great again only with trade wars and no credible industrial policies. We expect an additional substantial deterioration in the US balance of trade going forward (regardless of what Trump does in terms of "trade wars"), which will put a great pressure on the profits of American corporations.

Although 2015 was a difficult year for the Chinese markets, market sentiment has gradually improved over 2016. The main source of concern, the fast pace at which China was losing foreign reserves, has been temporarily solved by Beijing imposing tighter capital controls. The yuan has been depreciating against a basket of currencies in a smooth way (although since summer the value of the yuan has been stable against such a basket, but not against the dollar, showing the new PBoC's commitment to peg the Renminbi to a basket of currencies, not to the dollar). However, China's corporate leverage has increased even further, and the supply side reforms (meaning shutting down companies in uncompetitive industries) promised by the government have not materialized yet.

Although the government has been successful so far in managing the burst of the many Chinese bubbles that pop here and there (as it was the case with the real estate bubble in November this year), Beijing has still the formidable task of rebalancing the economy in a smooth way, and very little progress has been achieved on this front. We believe that Beijing will find it more difficult as time goes by, and therefore we remain skeptical of the prospects of the Chinese economy over the short-term.

Regarding the investment policy on currency, as of to date the portfolio is 100% fully hedged. In that sense, we have been fully hedged the whole year and we do not expect any changes to this policy in the foreseeable future.

This is a Buy & Hold Fund with an active management of global credit. This means that we will be over weighted wherever we find the best and most attractive credit opportunities. It is not the usual Buy & Hold, where there is a one-off analysis exercise and the investment is kept till maturity. Instead, we review and re-analyze our companies constantly. Quarterly results are incorporated to our credit models to keep track of the evolution of the business. Since inception, we have swapped more than 90 positions, whose credit quality fell below our strict standards. Rather than a Buy & Hold strategy, ours should be better depicted as a "Buy and Watch" one.

In geographical terms, we have been over weighted in Asia and Oceania (mainly in China and Singapore), but gradually reducing this exposure since summer. In turn, our portfolio has rotated towards the US market, where we found some interesting opportunities during the first half of the year due to the bearish mood against commodity markets, and the Nordic countries. In comparison to the previous year, we have started to build a small position in Latin America, in companies that we believe have durable competitive advantages and whose credit was bought at attractive prices given the market turmoil generated by the raising dollar and Rouseff's impeachment. We bought the credit of some protein companies that are leading producers worldwide (such as Minerva) and we also initiated a position in Sabesp, a water and sewage utility company operating in the Sao Paulo region. On the other hand, we have increased our tactical exposure to Russia, a geographical region where we were almost absent last year. We have initiated a position in leading regional banks that were out of favor due to Russia's recent economic performance, and in some mining companies, notably Polyus, a gold producer with one of the lowest cost profiles in the gold mining industry. Overall, our exposures are **26% in China & HK, 21% in Europe & UK, 27% in North America, 9% in Emirates & Eastern Europe & Africa, 12% in Asia & Oceania and 5% Central & Southern Latin America.** Finally, we still struggle to find good opportunities in the European (ex-Nordic) market. Monetary policies have kept yields to a minimum, and we believe that the investors who have been looking for higher yields in the European space have ended up buying very risky stories with extremely poor balance sheets. The only important addition to our European portfolio has been Debenhams, the UK retail distributor, which has a strong balance sheet and whose credit was (for current European standards) cheap, due to Brexit fears. But beyond this name, we keep waiting for a correction in the European high yield market to add some names to our portfolio.

In sectorial terms, we started the year heavily underweighted in energy and materials, the two sectors that suffered most beginning this year, so our fund did not display the volatility of our peers. Although we are still underweighted in these sectors, we have been gradually increasing our allocation to energy and materials since February, selecting those companies that we believe have prime assets and/or solid balance sheets. By way of example, we have initiated positions in i) Lundin Mining, a Canadian copper producer whose management's prudent approach to capital allocation has allowed the company to face low copper prices (2$/lb.) with an almost debt-free balance-sheet, and in ii) Consol Energy, a US coal and Nat gas producer with leading natural gas acreage in the Marcellus and Utica basins (the lowest-cost regions in the US) and very cost efficient long-wall thermal coal mines. The rally in coal, natural gas and (more recently) copper prices have moved meaningfully upwards the price of these bonds since when we bought them. Although we remain skeptical about the short/medium term price outlook for some of these commodities (especially in those in which China still plays a big demand role), it is worth repeating that many of these companies have leading assets and that their balance-sheets have materially deleveraged. As we have seen many times over the last months, when a crisis hits natural resource companies switch into a survival mode and become "capital allocators", shedding their best assets at low prices to pay down debt and survive. Although that is not good news for shareholders (who see that investments made in the peak cycle will never pay off), it is reassuring for creditors like us to see that top-notch assets can be sold to pay down debt even when the market situation is dire. Conversely, if the prices of these commodities stay high, we will be alert if our companies enter projects with lofty valuations and lever again their balance sheets.

As of yearend, the distribution by industry has **the maximum in Consumer (cyclical) with a 19.7% (Benchmark 12.39%) and the least in Communications with 4.74% (Benchmark 14.90%)** and a total variety of 11 different industries.

Our investments in China have behaved as expected and have brought stability to the overall portfolio in 2016. As usual, we have been focused on companies of the "New Economy", and not in industrials, mining and alike – the "Old China". Traditionally, we were also over weighted in Stated-Owned Enterprises (SOEs), because of the backing provided by the State. However, we have been reducing our exposure to the SOEs this year, given their high levels of leverage and the uncertainty about the rebalancing process – i.e. how the State will allocate the burden of the debt. Recent developments make us to believe that Beijing will try to get rid of overleveraged companies, forcing the private sector to ultimately shoulder the losses.

Our distribution of **Bonds in Investment Grade is 12.6%, BB is 43.4%, B is 8.85%, CCC is 1.91% and Non-Rated is 33.23%.**

Going forward, we expect to keep trimming down our Asian credit portfolio in renminbi's because, as we mentioned last year, the renminbi is very expensive to cover against the Euro (approx. 6% annual of negative carry) and, on the other hand, because we think the risk-return profile of many SOE's is not attractive any more. As we mentioned above, it is very hard to find in the European credit a favorable risk-return ratio. Although the USD hedge has become more expensive in the last couple of months, we still believe that we can find some opportunities in the US space. However, our investors should know that we are mindful about current valuations (in US and elsewhere), and that means we will be even more selective in our future investments and in the deployment of our funds.

Jacobo Arteaga Fierro
Investment Manager
Brightgate Capital SGIIC S.A.

BrightGate Capital, SGIIC
c/ Génova, 11 – 28004 Madrid
Tel. +34 91 441 0011
www.brightgatecapital.com