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"The future ain't what it used to be."
Yogi Berra

We would like to start with a quick summary of the fund. The fund closed on December 29, 2017 with a NAV of 115.09, which represents a net annual return of 4.01%. The fund was created on October 14, 2013 and the return since inception is 15.1%. The ISIN code of the fund is LU0942882589. During the 2017 fiscal year, the fund's T12 standard deviation was 1.26%, which gave us a Sharpe ratio of 3.45.

The philosophy of the fund is buy & hold with an investment mandate in global credit with durations below 3. The portfolio is relatively focused (between 55 and 70 positions) and includes our best ideas, which we believe offer a more attractive risk adjusted return than the average credit you can find in today's high yield (HY) markets. Although we would like to keep the positions until maturity, our fund is not in this sense a traditional buy & hold fund, where positions are bought and kept until maturity. We constantly evaluate our positions based on the price at which they are quoted and the evolution of the fundamentals of the business; in this sense our strategy could be called a buy & watch. In an environment like the current one, of narrow credit spreads and low interest rates, we believe that traditional buy & hold strategies are inappropriate for our investors' portfolios, since tight valuations make reinvestment of coupons a daunting task – coupons are used in the purchase of increasingly expensive bonds. We believe that the correct reinvestment of coupons is an important (and very often little appreciated) source of profitability in the long term; our investors can be sure that a large part of our attention is dedicated to this task.

Regarding the fund's currency hedging policy, the portfolio is currently fully hedged. The only exceptions, which represent less than 3% of the portfolio, are two credits in Mexico and Argentina, in which we are exposed to currency movements but which, on the other hand, give us high coupons as protection. We do not expect changes in the hedging policy for 2018.

Next, we will review how we have generated returns in 2017, what our main positions have been, how we see the markets and how we are positioned for 2018.

Summary of 2017

Unlike 2016, 2017 has been a quiet year in the HY markets. If in 2016 we saw large revaluations in the prices of many bonds linked to the basic materials and energy sectors following the recovery of commodity prices, 2017 has been a year in which returns have been mainly provided by coupons. The US High Yield BofA Merrill Lynch index (which is not fully comparable, given our greater geographical diversity and shorter duration, but which largely reflects the health of the HY markets) generated a return of 7.48% (in dollars) with levels of volatility (until November at least) abnormally low. The returns offered by the index, together with increasing hedging costs due to the monetary policy disparity between the ECB and the FED, have resulted in the high yield not being "high" for investors whose base currency is the euro, which have had to bear average coverage costs against the dollar in 2017 ranging from 2.0% to 2.6%, depending on the timing and period in which the currency was covered.

2017 was also the year in which we successfully completed the fund's new investment policy, rotating the portfolio that was going to mature in 2018 (and eliminating positions that did not generate any returns) to a portfolio with similar philosophy (duration less than 3) but with maturities of 5 years. In many cases we have simply replaced credits that we already had with other ones with longer maturities from the same issuer, and in other cases we have studied new companies in detail. The metrics of the portfolio during 2017 show that the investment philosophy has been (and will continue to be) exactly the same.

Despite the low volatility and increasingly tight valuations in the markets, we believe that we have found investments throughout the year with extraordinary credit quality for the yield they offer. In our portfolio, around 80% of it is invested in bonds whose aim is to generate stable coupons, while the remaining 20% are investments that we consider opportunistic, but that does not mean they carry more risk. As an example of these investments, we have been attracted to corners of the markets where we believe markets are more inefficient. Some examples of these transactions made this past year are shown below:

- ***Fallen angels*:** although the expensive valuations have also reached the fallen angels market (the limited 'offer' of fallen angels this year, coupled with the hunting for yield by HY funds, have meant that temporary situations of incorrect pricing in these securities have been short-lived), we have found credits with excellent fundamentals quoted at very good prices. At the end of May, Moody's cut the rating of **Petrofac**, one of the world leaders in engineering projects in the oil and gas industry, to Ba1, and the price of the bond that matures in 2018 dropped from 101 to 94. Petrofac received media attention due to their worse than expected results and a case of fraud with Unaoil (receiving a fine of an unknown amount), illegally obtaining certain contracts in Kazakhstan. These events created the opportunity to invest in a bond with a yield to worse of over 7% in dollars, one-year maturity and with a balance sheet in which the cash covered the financial debt of the company. The bond has re-priced at par and we sold the position a few months ago given the tight spreads of the bonds now. On the other hand, in August we bought bonds from the Canadian company Aimia, dedicated to loyalty point programmes, making it our top position. We have discussed the case of Aimia in our meetings over the last few months and won't repeat ourselves here, but we believed (and still believe) that the credit risk is minimal and that the yield paid by the bond when we bought it (9% in Canadian dollars) was not justified for a credit which expires in 2019, generates cash, has monetizable assets and a strong package of covenants. The bond is already trading above par (after having fallen from 105 to 80 due to the rating cut by S&P) and since we bought it the company has continued to maintain its route map (divesting non-strategic assets and results in line with the guidance). We are studying the possibility of taking a position in the company's preferred shares, which have also been severely punished (drop in prices of 70%) but which under our analysis redeem even in scenarios of serious drops (50%) in EBITDA.

- **Credit restricted by the country's rating**: at the beginning of the year we started taking positions in several credits of Ukrainian companies. Ukraine, which has been virtually out of the capital markets for years given its military conflict with Russia, has several excellent, well-managed companies that given Ukraine's rating (CCC) were considered junk credit by rating agencies, thus prohibiting the traditional, large institutional investors from accessing these credits. We have taken up positions in **Kernel** (from our point of view the best company in Ukraine, dedicated to the production of sunflower oil, vertically integrated and receiving most of its income in dollars), **MHP** (dedicated to the breeding and sale of chickens and eggs, also vertically integrated) and **Ferrexpo** (production of iron ore pellets). All of these companies still retained their extraordinary financial ratios when the conflict between Ukraine and Russia reached its peak in 2013-2014. We bought the credits with DFN/EBITDA ratios of less than 2x and interest coverage of more than 6. Since March, the bonds have appreciated significantly (especially those of Kernel, now trading at 110) and in some of them we have accumulated total returns close to 20%. We have recently liquidated our position in MHP (low yield at current prices) and we do not rule out the selling of the other two positions throughout 2018. Interestingly, as Ukraine's rating has improved, the ratings of these companies have improved as well (now with a rating of B), although from our point of view they are a much worse investment now than they were a year ago.

- **Special situations:** in general, we find that the market has difficulties in valuing the assets of holding companies, undervaluing them most of the time (a similar phenomenon can be observed in the equity markets). As an example, we have invested in **OHL** for more than a year in the bonds that mature in both 2020 and 2022, making it one of our main positions. Since the announcement of the sale of the concessions in October for 2,235 million euros to the Australian fund IFM, the bonds have been quoted above par, discounting the advanced redemption the company will make in the first quarter of this year. After the cut by Moody's in November 2016, the market was implying that OHL was another Abengoa or Isolux, and the bonds were paying over 10% in euros. Our valuations of the concessions gave us a valuation range between 1,600 and 1,900 million euros (which later proved to be conservative). In addition to the concessions, the development division (with the partial sales of Mayacobá and Canalejas, with real market valuations) provided additional cushion.

Finally, the last important source of profitability during the year has been our positions in energy companies, which have performed quite well, especially in the second half of the year. Although we remain underweight in energy with respect to the indices, the 4 positions we hold are those with the greatest conviction in the portfolio and with the greatest potential for revaluation. **Premier Oil**, a British production and exploration company with assets in the North Sea, Indonesia, the Malvinas Islands and Mexico, and Rowan Cos., a company dedicated to the rental of offshore drilling platforms (essentially jack-ups) have become part of our portfolio in 2017, and together with **California Resources Corporation** and **Enquest Energy** (acquired during 2016), complete our oil positions. We believe that all these positions are superior, both in risk and in profitability, to the average positions that can be found in a HY index, which in the case of the US is full of shale oil production companies, which we have written about in the past and whose business model seems very poor and whose bonds, paradoxically, have very tight credit spreads.

Although we will comment on the **Enquest** case later (since it is the one that has lagged the most behind in terms of price), we wanted to mention the progress of our position in CRC, since many clients have asked for it as it was the company with the highest returns in our portfolio for a long period of time. After having taken a small position in April 2016 in the 2nd lien bonds around $40, these bonds closed in 2016 around $ 90, to be quoted in mid-2017 around $ 50 (when the pessimism for energy companies was extreme, despite clear signs that the market was already rebalancing), at which point we decided to increase our position again. Since then, spurred by higher oil prices, new joint-ventures to unlock the massive asset base (more than 700 million barrels of onshore reserves, measured at the end of 2016 when oil was cheap, of which most was already developed) with no CAPEX upfront, along with a restructuring of debt in October, prices have risen again to $90, with a YTW still of 12%; however, with oil prices at these levels we believe is a story with minimal credit risk.

The successes have, unfortunately, compensated in a small part by some errors, from which we have learned some lessons. Especially in two cases: **JBS** and **Rent-a-Center**. They are two bonds that have fallen in value, and that although each represented the 1-1.25% of the portfolio and the loss in each has been no more than 10%, they will be good lessons to learn from. In the case of JBS, we failed to appreciate the value of the US business (Pilgrim's Pride) and the diversification that **JBS Holding** has geographically and on a product level (chicken, pork and beef), allowing us to be influenced by the negative news related to the Batista brothers and the possibility of using asset transfers in a corporate structure that was quite convoluted. In the case of **Rent-a-Center**, which operates more than 2,500 stores in the US and 150 in Mexico dedicated to the rental of electronic products (televisions, smartphones, etc.) with the possibility of purchase at the end of the rental period, we have learned that we are more comfortable if the American retail credits have properties as collateral (which was not the case with **Rent-a-Center**, whose premises are leased). After several disappointing results we decided to close the position knowing that we would have little visibility of future cash generation: although the price of the bond has since recovered and the results have stabilized, we thought that the sale was a correct decision.

Current Position and year 2018

Regarding the rest of 2018, the geographical positioning of our portfolio is as follows: 52% in Europe, 25.6% in the US and Canada, 14.5% in Asia and 7.9% in the rest of the world. Although we invest mainly in Europe, we do not own a single bond in 'traditional' Europe (France, Germany, Italy, etc), which we believe to be absurdly expensive and will correct sooner or later, but in the northern European countries, the United Kingdom (oil companies), Ukraine (Kernel) and Spain, where we continue to hold a position (although smaller) in **OHL** and in the construction companies **Copasa** and **Ortiz**. The Nordic part of our portfolio is composed mainly of floating bonds, providing good protection in a hypothetical rate hike environment. On the other hand, as we discussed in last year's letter, we have substantially reduced our exposure to Asia, not because there are no attractive companies, but because once the renminbi hedging cost has been taken into account, bond yields are unattractive. We expect few changes at the geographical level as long as coverage costs do not change.

Furthermore, the weightings of our portfolio by ratings are: investment grade 5.9%, BB 20.7%, B and CCC 28.6% and non-rated 44.8%.

At sectoral level, the main weights of our portfolio are: industry 19.6%, cyclical consumption 16.9%, financial 11.3%, energy 10.1%, defensive consumption 7.1% and basic materials 7%.

A priori, 2018 will be a year with tight valuations in the high yield markets, with the danger that any small correction will erase any return coming from coupons, so we believe the best way to add value this year is to detach ourselves further from the indices and be where no one else is. As Yogi Berra once pointed out in the sentence with which we began this letter, *"The future ain't what it used to be"*, a phrase that sums up perfectly our vision for 2018, a year that we believe will be different to a typical year in HY. At the end of December, our invested portfolio has a gross YTM of 6.75% (around 5.5% net of currency hedges), and we have a position of 16% in cash and liquid short-term investment grade bonds (11% in cash and 5% in bonds), with a duration of 2.1. We believe that this defensive positioning, together with the diversification of the portfolio, will allow us to obtain a reasonable return in 2018 and at the same time provide us with sufficient flexibility for the opportunities that may arise throughout the year.

At the macroeconomic level, as HY investors in short-term markets, our only concern is the health of the Chinese economy, given the high levels of indebtedness and the difficulty that companies will have, due to the lack of aggregate profit generation, in facing the transition from an economy driven by investment to one led by consumption. We believe that Europe (despite higher oil prices and more unfavourable exchange rates than last year) and the US will continue to grow at reasonable rates (Europe more than the US), and we have little concern in our portfolio for i) aggressive paths in the monetary policy of the respective Central Banks, or ii) higher levels of inflation than expected. Milton Friedman used to say that "inflation is always and everywhere a monetary phenomenon" (for which extreme examples are given and taken out of context like that of Germany in 1923 or the South American countries several times in the last 100 years), a statement with which we cannot disagree more. Inflation is a monetary phenomenon in countries with weak and unstable political regimes: in the rest of the world it is and has been most of the time a wage phenomenon and given the growth of wages in the Western world over the last two decades, coupled with growing inequalities in income and wealth, we do not expect any significant rise in short-term inflation.

Although our analysis is at the level of an individual company and we do not know when or where the next opportunities will present themselves, we can comment on the parts of our portfolio in which we still see value as well as our thoughts on some sectors that can offer attractive investment opportunities in the future.

Regarding the undervalued positions of our portfolio, we mention two as an example. We commented before on the case of **Enquest**, one of our energy and main positions in the portfolio, an offshore oil producer in the North Sea that has lagged during 2017. We took the first position of **Enquest** in the last quarter of 2016, shortly after OPEP announced its decision to cut production, around $70. The company had undergone a recent debt restructuring and we saw that it was not going to have financial problems to start up Kraken, the field in which they had been investing since 2013, which came into operation in June 2017 and that was practically going to double the company's production. Problems with Kraken's performance, along with the previously mentioned pessimism of the energy companies half way through the year, led to the bonds falling from $80 to $60, closing the year around $70 (around the price to which we bought them), once it was confirmed that Kraken was already operating at very high utilisation rates. As the year progressed, we began to increase our position. We believe that the bond is worth par even at current Brent prices, so at the closing prices of 2017 we believe that **Enquest** will be one of the major sources of return for 2018 (at the time of writing this letter the first weeks of January, the bonds have been priced up at 80).

Imperial Metals is another position that we believe will help us in 2018. Imperial Metals is a mining company dedicated to the extraction of copper and gold, with two mines in Canada, Mount Polley and Red Chris, its flagship project. We acquired the position after the summer, when the company released worse results than expected due to forest fires that impeded work in Mount Polley and worse mineralization than expected in Red Chris. Given that Red Chris is a mine with very low costs per pound of copper (producing a high quantity of gold as a by-product) and a life of mine of 100 years at current production rates, we believe that the valuation of Red Chris justifies the entire debt of the company and part of the equity, with Mount Polley as an additional free option. Furthermore, we are with the best possible partners, since the main shareholders (and also bondholders) of the company are Murray Edwards (the founder of Canadian Natural Resources), and Bruce Berkowitz, the CIO of Fairholme Funds. Both shareholders have always expressed their interest in long-term projects with excellent competitive advantages (costs in this case), so we believe that the refinancing of the bond in 2019 (of which they also have a significant percentage) should not present any problem. The bond is quoted at 94 with a yield to maturity of 13%.

We believe that the American retail industry presents very attractive investment opportunities over the next few years. Despite the healthy US economy, many malls (like **Sears, JC Penney, Macy's**) and other retail businesses are not seeing their profits grow (and decreasing in some cases), not only due to the growth of online commerce, which continues to take the market share from traditional shops, but from changes in consumers' habits and alternative leisure activities. We have taken up small positions (less than 3% of the portfolio) in the sector with **Sears** and **JCP**, given the attractive price the bonds were listed at. Both are companies in which we do not take into account any recovery of their business, but we think that (in contrast to the **Rent-a-Centre** case discussed above) they have a vast asset base that comfortably covers the value of the bonds. We believe that Sears, which we have analysed extensively, will be one of the most interesting cases to follow during 2018, not only for the company itself, but also because of the domino effect that will create the closure of its stores in other companies of the sector leasing properties to Sears, such as **Seritage Growth Properties, Washington Prime Group or CBL Properties**. Many of these companies have bonds (and preferred shares) that we do not consider attractive at this time, but we do not doubt that we will find then more attractively priced in the future.

We would like to conclude by thanking you for the trust you have placed in us. We only hope that the results that we produce in the future continue to maintain the same level of trust.

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