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"All Cretans are liars"
Epimenides' paradox, enunciated by the Cretan philosopher Epimenides in S. VI

We would like to start with a brief summary of the fund. The fund closed on the 29th June with a NAV of 113.67, which represents a net return of -0.96%, making the total return of the year -1.23. The fund began on 14th October 2013, and its profitability since inception has been 13.67%. The ISIN code for the fund is LU0942882589.

The first half of the year has been generally difficult for the fixed income space without exception. Investment grade credits (BBB or higher) and emerging markets have been significantly more penalized than high yield credits (which make up the bulk of our portfolio), due to the progressive increases in the Federal Reserve´s interest rates, the impact of the incipient commercial war on the investment community psyche, the strengthening of the dollar and, above all, some valuations (expected returns) that were very expensive from a historical perspective at the beginning of the year. The Bloomberg Barclays Global Credit IG index, which is a good proxy for the performance of the investment grade universe, closed the quarter with a return of -3.4% (in euros), while the Bloomberg Barclays Emerging Markets Corporates TR index, which represents the evolution of emerging market credit, closed at -4.5%. Finally, our closest comparable by asset type, the Bloomberg Barclays Global High Yield Return Index, closed at -3.2%

However, it was not due to our exposure to investment grade or emerging credit (or major high yield names held in any ETF) that the quarter was negative (our portfolio had a residual exposure to this type of credits during the quarter), but due to one of the positions that we held in our portfolio, the Greek designer and jewellery manufacturer Folli Follie, which fell 60% in May following a report from a hedge fund which had discovered alleged irregularities in the accounting of some of the subsidiaries of the company. As we will now explain, we believe that at current prices the bond presents a very attractive buying opportunity that will materialise in the coming months (the bond expires in 2019).

Next, we will review the main positions of the portfolio and the outlook for the rest of the year.

The "folli" of the markets?

On Friday, May 4, Quintessential Capital Management (QCM), a small hedge fund (according to Bloomberg) of less than $ 50AUM, published a damaging report on one of the companies that we held in our portfolio, the Greek manufacturing company and jewellery designer, Folli Follie (FFGRP), a family company and also owned by the Chinese investment holding firm Fosun. In addition to jewellery sales (most of them coming from China for geographical reasons), FFGRP also has retail operations (it operates several shopping malls in Greece) and represents third-party brands (Calvin Klein, etc.) in Greece, Romania and Bulgaria. In the QCM report, the veracity of certain information published in the 2016 annual report was questioned and the short sale of FFGRP shares was announced. Among other issues, QCM questioned the alleged number of points of sale in China, as well as the level of income and real profits of the Asian division of FFGRP in recent years.

Shortly after the publication of the report, the stock collapsed, losing more than 60% of the market capitalization in a few weeks. The bonds that expire in 2019, in which we are invested, also lost more than 60%, finally stabilizing around 47. The action was suspended by the Greek regulator and the company has been unable to clarify several issues relating to the validity of the financial statements of its Asian subsidiary. As a result, the regulator has forced the company to carry out an independent audit, the results of which are expected in August. The fraud committed by FFGRP is also a setback for the Greek authorities, who have been striving to demonstrate in recent years that with financial matters (and paraphrasing Epimenides) not "*All Greeks are liars*".

Since then, several events have developed (which we will now detail), but essentially our sum-of-the-parts valuation of FFGRP has not substantially changed. We believe that the assets held by the holding company (which guarantees the bonds) cover the company's debt, without counting what value there may be in the subsidiaries and in other annexed assets. In summary, the holding company had at the end of 2017 a cash balance of 154.5 million euros. In addition, the company has receivables of 89M and 117M (of which we estimate in our baseline scenario that 40-50% could be recovered), a balance of inventories of 46M (with recoveries of 30-40%), an important stake in the Swiss company Duffy AG, world leader in the segment of duty frees, valued by the market at this moment around 190M, and finally, properties at 121M, which we believe could conservatively be worth 50-80M. The sum of all these assets, valued between 442M and 565M, covers in a conservative scenario 95% of the value of the bonds, and in a more reasonable scenario more than 100%.

All of this does not account for the value of some subsidiaries and assets that are outside the Asian business, in particular the participation of FFGRP in Attica (the company in charge of operating the shopping centres in Greece), which we value around 150M (or about 50M adjusted to the participation of FFGRP), the distribution business in Romania and the jewellery brand Links of London (we have calculated that the latter could raise an additional 75M). Finally, and as an additional option that is not currently included in the price of the bonds, the Asian subsidiary (although we do not doubt that less assets will eventually be discovered than previously believed) has inventories and receivable accounts worth approximately 700M, which are, assuming minimal recovery scenarios (of 5%), a source of additional value.

Furthermore, since May we have united with other creditors who are also invested in the ’19 bond, in order to pursue legal action against the company. We are represented by a British legal firm who are leaders in their field in these types of operations and by a Greek firm, and we represent around 40% of the bond issue. Our objective is to force the company into negotiations and find solutions to ensure the recovery of our principal. Since the independent audit results are not released until August and the company has continued to pay the coupon, we do not expect to see any significant increase in the price of the bond before this date. However, we would like to mention that many parallels can be drawn between this FFGRP case and that of the South American company Steinhoff, which in September of last year was also subject to accounting irregularities and whose bonds fell to 40 and are now trading at 90. Although comparisons can never be entirely accurate, the quantity of assets in the balance sheet of these types of companies guarantee more often than not a full recovery, provided that one has patience during the restructuring/negotiation process.

“Emerging” Opportunities

With the exception of Folli, the strong performance of the rest of our portfolio relative to the indices throughout the first quarter of the year has enabled us to sell the bonds which reached our target price in order to increase our exposure to emerging economies, which have been seriously affected by the gradual rate hikes of the Federal Reserve, by being an election year (Turkey and Mexico) and, by balance of payments problems in those countries that exhibit serious imbalances, as is the case in South Africa and Turkey. This rotation has allowed us to invest in credits with very attractive yields (in some cases over 10% in dollars) and with similar (or even better) credit risks than in the United States.

The following table shows some examples of recently acquired bonds that we knew well but were not invested at the beginning of the year because credit spreads were tight. In some cases, we believe that the punishment of the market has been excessive:

Name	Bond Characteristics Currency	Coupon	Maturity	Rating	Maximums of 2018 Price	YTW 2018	Date	Current Data Px bought 7/5/2018	Yield bought 7/5/2018	Maximum decline
SSMS	USD	7.75	23/01/2023	B	102.10	7.20%	Jan-18	87.990	11.2%	-13.82%
STILLWATER	USD	6.125	27/06/2022	BB	102.81	5.27%	Jan-18	89.529	9.3%	-12.92%
KERNEL HOLDING SA	USD	8.75	31/01/2022	B	110.98	5.61%	Jan-18	98.070	9.4%	-11.63%
GEO COAL INT.	USD	8	04/10/2022	B	102.34	7.32%	Jan-18	91.298	10.6%	-10.79%
AEGEA FINANCE SARL	USD	5.75	10/10/2024	BB	102.00	5.34%	Jan-18	92.737	7.2%	-9.08%
TV AZTECA SA DE CV	USD	8.25	09/08/2024	B	107.74	6.73%	Jan-18	98.445	8.6%	-8.62%
TURKIYE GARANTI BANK.	USD	5.25	13/09/2022	BBB	102.94	4.48%	Jan-18	94.777	6.7%	-7.93%
ATENTO LUXCO 1 SA	USD	6.125	10/08/2022	BB	104.71	4.91%	Jan-18	96.535	7.1%	-7.81%
AKBANK TAS	USD	5	24/10/2022	BB	101.75	4.56%	Jan-18	94.828	6.4%	-6.80%
Average		**6.8**	**0**	**BB/B+**	**104.2**	**5.71%**		**93.80**	**8.5%**	**-9.9%**

In general, although the market may not give us the reason in the short-term and the credits may continue to fall some points, the only concern that we have with these types of companies, excluding the usual ones, is the gap that can occur between their currency of operations and the dollar, which is usually the currency in which they issue debt. Therefore, when we invest in companies in emerging countries, we look for any of these characteristics:

- ***Income in dollars:*** obviously this is the first and most important characteristic. Companies such as Geo Coal (coal miner in Indonesia), Sawit Sumbermas Sarana (palm oil in Indonesia) or Kernel (sunflower oil in Ukraine) sell products in international markets linked to dollar indices. In all these cases, the depreciation of the local currency has no impact on income converted to dollars.
- ***Costs in local currency:*** this is the other side of the coin, and just as important as the first. Sibanye-Stillwater (gold and PGMs miner in South Africa and the United States) has a large part of its cost base in South African Rands, so that when the currency depreciates, not only does it receive the same amount of income in dollars, but its cost structure is considerably cut. In fact, these types of companies reap the most rewards at an operational level when there is panic among investors concerning emerging markets.
- ***Issuance covered with derivatives:*** in some cases, although the business does not have a natural protection against exchange rates, the company may have covered its issue of debt in dollars with derivatives. Atento, a Brazilian call centre company, has resorted to such a solution.
- ***Solid balance sheet or leading company in the sector:*** finally, and only in very exceptional cases, we accept the risk of currency mismatch. In the cases of Garanti and Akbank, both Turkish banks, we have accepted to invest in *unsecured* debt knowing that of the seven big Turkish banks (a sector that historically has generated high returns with solid capital ratios) these present the most solid numbers and that are backed by investors (BBVA in the case of Garanti).

We do not know what the future holds, nor can we tell what will happen with the trade war or the restrictive monetary policies, but in the case of the emerging credits mentioned above, we believe that we are buying the best balance sheet with the best yields in comparison to United States' credits (that goes without mentioning the European credits, which we continue to believe present the worst profit/risk relationship in the high yield universe). In some specific cases, we believe that a couple of presentations of results will be enough for the analysts to refocus on the real evolution of the businesses and on the cold financial numbers, and not on the *beauty contest* (the bad habit of guessing what the rest of market participants think) of when the current sell-off will end.

Further Updates

As for the rest of the positions in the portfolio, it is worth mentioning that despite the revaluations during the first quarter of the year, we remain positive about our positions in energy, especially CRC, Enquest and Athabasca – all of which are main positions in the fund. They are bonds that (on average) continue to pay above 9.5% in dollars and have a very positive outlook, given the lack of investment in upstream over the last 3 years. Despite the short-term volatility which may well have been due to OPEP partially reversing the cuts announced at the end of 2016, the lack of idle capacity in many of its members (not only in Nigeria, Libya, and Venezuela, where production is falling at an accelerated pace, but also in countries which are, in theory, "strongholds" such as Saudi Arabia and Kuwait, whose capacity we believe is lower than is normally assumed) means the cuts will be more nominal than effective. On the other hand, it is expected that the growth of the Permian basin (the basin from which the largest production growth is expected in the US this year) is slowed down due to a lack of capacity of the pipelines that transport the product to the Gulf of Mexico (in fact, the spreads in recent weeks of the Permian index, the Midland Basin, with respect to the WTI, have been widened as a result of these restrictions). Ruling out a global recession, we continue to be very optimistic about short term oil prices, and in fact we believe that already by the end of this year and at the beginning of the next, these high prices will start to significantly slow down global economic growth.

Finally, there have been a few developments during this quarter in our main position, Aimia. Firstly, Aimia listed one of its business lines, Cardlytics, in the Nasdaq in February 2018, crystallising the value of the investment, which is now worth more than CAD60M. Additionally, Aimia announced in February the (very bad) sale of the British points business to Sainsbury, which has led to Chris Mittleman, shareholder and owner of 10% of the company, taking a more active position in the investment and requesting seats in the board. The involvement of Mittleman, which we believe will prevent further infantile mistakes of this type, along with good business performance (especially in its Mexican points division, Club Premier, whose EBITDA has been growing annually in the first quarter of the year at rates of 20%), will facilitate the partial refinancing of the bond that expires next year and will also boost the value of the preferred shares, which are currently trading at a discount to our fair value of more than 50% and that have not paid any dividend (but that accumulates at 6.5% annually) from May of last year. In the bond, after increasing our position at the beginning of the year, we have a buying average price of 97 (current price of 99) and one full year of coupon (6.5%), whereas in the preferreds, after taking into account the accrued dividend, we are flat. Aimia will present its results in mid-July, in which in addition to seeing the progress in obtaining synergies that the company is making as a result of the sale of the British business, we are expecting news that will help us gain clarity about i) development of the Aeroplan program post-2020, ii) the possible disinvestment of Aimia's participation in Cardlytics and iii) how they plan to adapt the capital structure to the new reality of the business.

Current Position

With regard to the rest of 2018, the geographical positioning of our portfolio is as follows: 39.23% in Europe, 38.43% in the US and Canada, 8.52% in Asia and 13.82% 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, in 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**.

Furthermore, the weightings of our portfolio by ratings are: investment grade 2.7%, BB 17.7%, B and CCC 32% and non-rated 34.1%.

At sectoral level, the main weightings of our portfolio are: industry 14%, cyclical consumption 8.51%, financial 5.71%, energy 19.33%, defensive consumption 9.94% and basic materials 8.5%.

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