

Beaten by the euro

The second quarter was very much about a stronger Europe, both politically and economically speaking. The victory of Emmanuel Macron in France led to renewed hope of a strong and united euro area. Furthermore, the European economies continued to perform well with higher growth and falling unemployment. This all contributed to an appreciation of the euro.

The negative absolute performance in the quarter was due to the currencies in the portfolio depreciating relative to the euro. The main negative contributor was the USD. The dollar depreciated by 7 percent relative to the euro in Q2. The Latin American currencies in the portfolio, except the Mexican peso, depreciated along with the USD. The other currencies in the portfolio also depreciated relative to the euro, but by less than the dollar depreciation.

Positive developments in Portugal

The Portuguese bond in the SKAGEN Tellus portfolio was the best performer in the second quarter. The interest rate on the fund's Portuguese bond fell by 85 basis points and led to a bond price appreciation of 6.5 percent. This is due to positive developments in the

Portuguese economy. Annual GDP growth was 2.8 percent in the first quarter, up from 2.0 percent in the fourth quarter of 2016. It is positive that the stronger growth was attributable to an increase in both investments and exports. Export growth is mainly driven by stronger growth in Europe. Furthermore, Portugal reached an important milestone in May when the EU declared that for the first time since the debt crisis Portugal is no longer in breach of the Growth and Stability Pact, which states that a country's budget deficit cannot exceed 3 percent of GDP. The budget deficit is now at 2 percent of GDP.

Going forward, we still see opportunities for falling long-term rates in Portugal. The Socialist Minority Government has proven to be resilient, implementing a sound fiscal policy. A sustainable responsible fiscal policy and positive economic developments may pave the way for one or more of the major rating agencies to upgrade the country to investment grade. This would be very positive for our investment. The spread between Portuguese and German 10-year interest rates is currently 250 basis points, which means that there is still considerable potential for a fall in the credit spreads going forward.



The Portuguese bond was the best performer in Q2. Manuel Caldeira Cabral, Portugal's economy minister is pictured here. Photo: Bloomberg



We are invested in a Mexican peso bond that matures in 2029. Photo: Bloomberg

An actively managed fund

Despite a weak absolute performance in the second quarter, the relative performance was strong. This was mainly due to an underweight in USD and JPY. While around 15 percent of the fund is invested in USD denominated bonds, the index's USD weight is 38 percent. Furthermore, SKAGEN Tellus is not currently invested in any JPY-denominated bonds, while the index JPY weight is 19 percent. Both USD and JPY depreciated sharply relative to the euro in the second quarter.

The significant underweight in JPY and USD illustrates the extent of active management in SKAGEN Tellus. This is further emphasised by the large difference between the duration of the fund and that of the index. The duration in SKAGEN Tellus is currently 4 years, which is substantially lower than the index's duration of 7.8 years. Given the current state of the business cycle, we only take interest rate risk in countries where there is still a solid case for a fall in the interest rate going forward and/or the yield is very attractive.

Outlook

We have longer duration in countries where we expect the credit premium to fall, such as Portugal and Croatia, or where there is a high running yield, e.g. Peru, Mexico and Chile. We have very low duration on our investments in the US, UK, Canada and Norway. These holdings are based on an expectation of an appreciation of the currency.

At the end of the quarter, we chose to extend the duration in Mexico. We invested in a local currency bond that matures in 2029. The motivation for the investment is that we believe inflation has peaked and that the central bank's next move will be a cut in the policy rate. Moreover, the credit premium is too high given all the negative news around the risk associated with Trump's policy and especially the North American Trade Agreement, NAFTA. Trump is under pressure from strong interest groups that are working for an improved NAFTA rather than an agreement that limits trade with neighbouring countries. We think this will lead to a renegotiated deal that will be a win-win agreement for both the US and Mexico.

SKAGEN Tellus invests primarily in bonds and certificates issued or guaranteed by governments from around the world.

The fund is suitable for those with at least a three year investment horizon. Investors must be able to tolerate currency fluctuations.

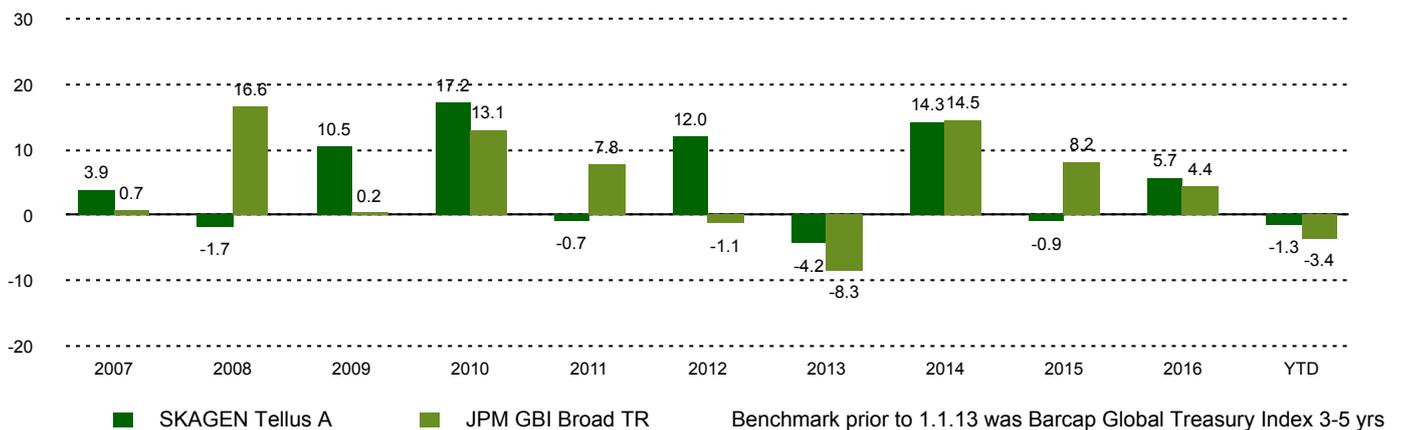
Historical performance (net of fees)

Period	SKAGEN Tellus A	Benchmark index
Quarter to date	-1.9%	-3.6%
Year to date	-1.3%	-3.4%
Last year	0.6%	-6.6%
Last 3 years	2.9%	5.7%
Last 5 years	3.6%	2.2%
Last 10 years	4.7%	5.2%
Since start	5.0%	4.4%

Fund Facts

Type	Fixed income
Domicile	Norway
Launch date	29.09.2006
Morningstar category	Global Bond - EUR Biased
ISIN	NO0010327786
NAV	12.67 EUR
Fixed management fee	0.80%
Benchmark index	JPM GBI Broad TR
AUM (mill.)	100.50 EUR
Duration	3.99
WAL	5.30
Yield	2.78%
Number of holdings	14
Lead manager	Jane Tvedt

Performance last ten years



Contributors in the quarter



Largest contributors

Holding	Weight (%)	Contribution (%)
Portugese Government	6.92	0.75
Croatia Government	8.04	0.47
Mexican Government	6.03	0.37
Spanish Government	6.03	0.33
Slovenia Government	4.64	0.23



Largest detractors

Holding	Weight (%)	Contribution (%)
US Government	15.80	-0.40
Chilean Government	6.31	-0.04
EU Bank Recon & Dev	2.76	-0.02
Dominican Republic	3.04	-0.02
Canadian Government	5.28	0.00

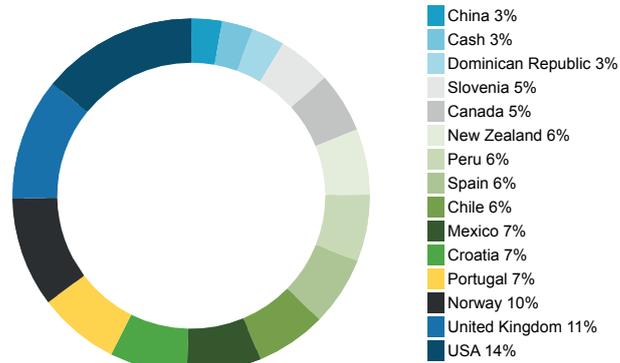
Absolute contribution based on NOK returns at fund level

All data in EUR as of 30.06.2017 unless otherwise stated.

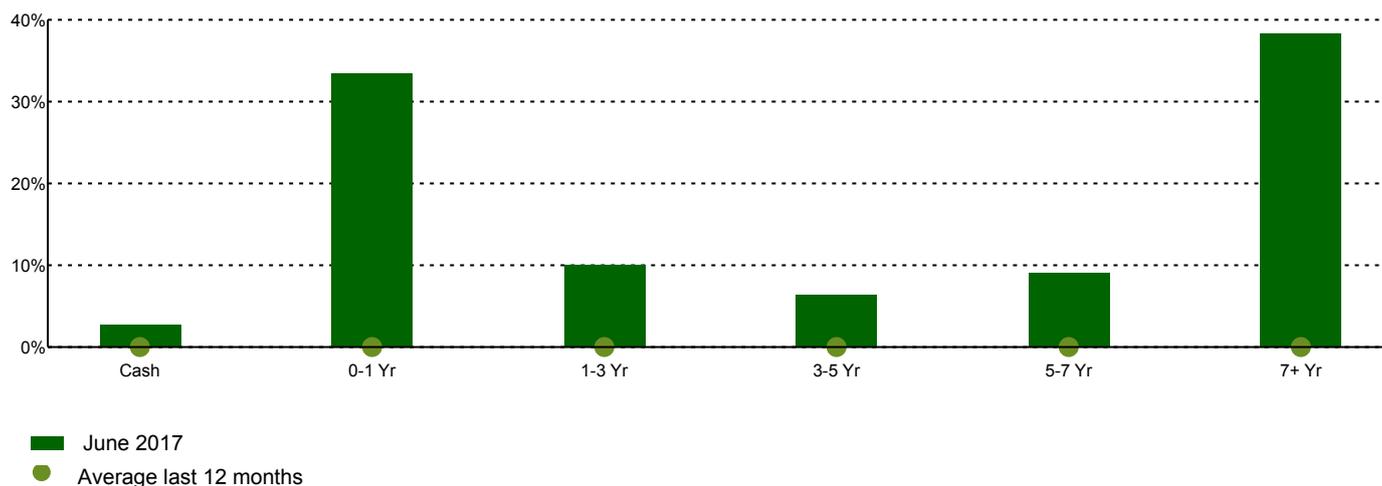
Top 10 investments

Holding	Percentage of Fund
US Treasury N/B	14.11
UK Government	11.13
Norwegian Government	10.00
Portugese Government	7.37
Croatia Government International Bond	7.02
Mexican Government	6.71
Republic of Chile	6.36
Spanish Government	6.28
Republic of Peru	6.10
New Zealand Government	6.01
Total	81.10

Country exposure



Maturity structure



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