LEVENDI

THE FUND AS A REPLACEMENT FOR CORPORATE BONDS IN PORTFOLIOS

24th April 2019

INTRODUCTION

The Levendi Thornbridge Defined Return Fund (the Fund) is a lower risk fund that aims to offer steady returns. As a result, it can be used in several ways. Because of the defensive strategy we use, there are some investors who see the Fund as a bond replacement. There is a strong case for this. The fund uses defined return investments to implement a long dated, low strike covered put strategy. Corporate Bonds are in effect also a covered put strategy – the main difference is that the put in a corporate bond is implicit and on the enterprise value of the issuer. It is this embedded risk that drives the higher return in corporate bonds, the greater the risk of default, the greater the yield. The short put in corporate bonds is the link that causes the correlation between equity and corporate bonds to be higher than the link between equity and Gilts or treasuries.

The fundamental difference is that investors are replacing the risk of individual corporate defaults in a bond fund with the risk that equity markets fall significantly over a protracted period. These risks are clearly closely associated. The sort of fundamental conditions that would cause equity markets to be 40% or 50% lower in eight years are likely to lead to higher instances of corporate defaults.

COMPARING THE RETURNS

The empirical evidence demonstrates that the Fund can be an effective replacement for corporate bonds. The chart below from Trustnet shows the Fund returns over the last 12m versus two other lower risk sectors

- GBP Corporate Bonds
- Mixed Investment 0-35% shares

Cumulative Performance | Discrete Performance | Annualised Performance | Select All

Key	Chart	Instrument	1m	3m	6m	1y	3y	5y	10y	Since Launch
A	✔	Levendi Thornbridge Defined Return B Acc	1.1%	3.1%	3.2%	3.7%	-	-	-	6.4%
B	✔	IA Sterling Corporate Bond	-0.1%	3.1%	3.4%	3.1%	13.5%	23.7%	96.1%	424.7%
C	✔	IA Mixed Investment 0-35% Shares	0.6%	2.9%	2.9%	2.4%	12.5%	19.3%	68.1%	445.9%

The broad pattern of returns for all three assets over the last year is similar. This is what we would expect.

REASONS TO CONSIDER THE FUND

At this stage in the cycle we would propose that our fund may be a good asset to hold instead of corporate bonds for the following reasons

- High Carry – the fund has a carry of about 6.7% per annum (on the fact sheet this is the average return when there is a positive return). The average yield in the GBP Corporate Bond sector is about 2.7% (High yield is 4.5%)
- The fund does not rely on falling rates for capital growth – is the positive news for bonds in the price? Have rates now discounted the reduced inflationary expectations and the more dovish tone from central banks?

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- Better liquidity – if there are redemptions the issuers can easily decrease the notional value of the swaps we hold or redeem notes. There is no need to find a 3rd party buyer
- Less default risk – the Fund have some (35%) exposure to the issuers of products – but they are all investment grade
- No exposure to covenant-lite issues – increasingly common for lower rated issuers
- Minimal rate exposure – we have a very small level of exposure to changes in rates – rising rates are negative for the fund.
- The risks for investors in the fund are clear, obvious, quantifiable and can be hedged as required.

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