BI SICAV Emerging Markets Corporate Debt I (USD)

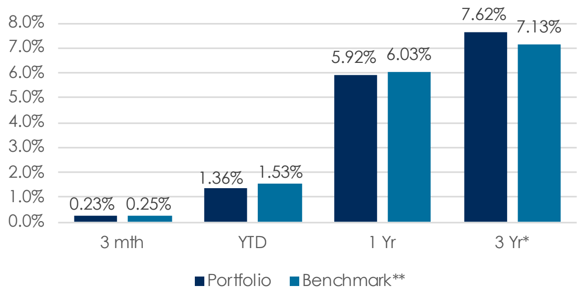
Dear Investor

Please note that information regarding companies (issuers) and financial instruments (e.g. shares or bonds) in this investor letter shall not be considered as investment recommendations to buy, sell or hold any financial instruments. Information about companies and financial instruments shall only be considered as information concerning the fund's portfolio and risk profile for that quarter.

Summary

- Q3 yielded a small positive return with marginal changes on rates and spreads over the quarter, but large swings intra-quarter
- China in particular attracted investors' attention as the regulatory crackdown spread into both health care and gaming whereafter the most indebted property developer missed a coupon payment triggering ripple effects across markets
- Energy prices continued their ascent together with continued supply chain bottlenecks which have triggered increasing concerns of a rising inflationary environment
- Overall Emerging Market spreads performed in line with developed markets although this masks that EM HY continues to trade at elevated levels compared to its historic relationship with US HY

Return



Portfolio performance is net of fees

* Returns over 1 year are annualized

** Benchmark is JP Morgan CEMBI Broad Diversified

Risk figures (5 year, ex post)

Standard Deviation	N/A
Tracking Error	N/A

Testing the foundation

While spread and rate changes over Q3 seemed negligible, the quarter was full of large intra-quarter drama. As an example, the 10-year US treasury rate increased by only 4 bp but went through a trough of 1.12 % to currently at 1.54% indicating the resumption of volatility in the rates market. Likewise, Emerging Market corporate debt only posted a marginal increase in spreads of 9 bps despite large spread moves among particularly Chinese high yield issuers which overall led to an index total return of 0.25 % for Q3 which the fund handsomely outperformed by 25 bps gross of fees. EM credits performed broadly in line with DM credits despite the noise in China credits indicating little fear of contagion out of China.

The Chinese regulatory crackdown moved from the tech sector to also include health care and the gaming industry, notably the casinos in Macao which suffered large drops since the government released its consultation paper on revision of its Gaming Law. The proposed tightening in our view remains harsher for equity than bondholders and could be seen as part of the continued US/China disputes as some of the worst hit Macao casinos are US owned. We do not foresee the sector to be forced into a wind down but prefer to stick with more financially conservative operators with predominantly local ownership.

One of China's largest (and most indebted) property developers did also attract global interest as it defaulted during Q3. While this was long in the making and bond prices already reflected its dire situation, it increased the fears of contagion and systemic risks for the Chinese financial system. While there was no doubt, that Evergrande was in an unsustainable financial position, it is our anticipation that the Chinese government will do its utmost to engineer a restructuring to avoid any social unrest from property owners not receiving their prepaid new homes or the repercussions from bankrupt suppliers. As a predominantly still state controlled economy, the Chinese government does still have the financial strength to counterbalance these risks and most likely will reverse its tightening of credit impulse as one of the tools, as it already has begun through liquidity injections in the banking system. A broader solution will take time, however, and the sectors woes will not be solved within the next few months and that leads to the risk scenario for the broader sector as confidence in several property developers dwindles. First signs of this are already evident as several property developers are reporting large declines in sales during September which together with October traditionally are the strongest months. To add to the worries, another mid-sized developer has also announced that it will not meet its principal payment and to us this escalating risk for developers not paying either due to inability or lack of willingness will continue to be present until the government has put up a credible framework for the future of a sector which has hitherto contributed to a significant share of the Chinese growth model. Given this utter lack of transparency, we have decided to reduce our exposure to the sector further particularly bearing in mind that the dilemma facing Chinese authorities is that they need to reduce wealth and social inequality whilst still aiming at avoiding the middle-income trap and growing old before the population, not only the select few, grows old. At the same time, President Xi's power consolidation continues which together with the other factors spell volatility ahead.

Disrupted supply chains and inflation

The continuation of supply chain bottlenecks and soaring container prices have together with an ongoing energy crisis in Europe led to concerns of runaway inflation and even comparisons of 1970's stagflation. The energy shortage has many causes stemming from a cold European spring and a hot Asian summer on top of the post-pandemic industrial reopening adding to less winds across Europe and draughts affecting hydropower in multiple countries. Moreover, the decarbonisation focus and lack of nuclear energy only amplify the need for gas at a time when Russia ships less gas to Europe at a time when it is lobbying and waiting for Nordstream 2 approval. Had it not been tragicomic, one would have dubbed this the perfect storm. Nonetheless, we perceive that the energy led spikes in commodity prices are transitory of nature, but that a coming cold winter would bring further pressure on prices and households, plus potentially people to the streets. Other hard commodities like timber, iron ore and metals seem however already to have peaked affected by defunct supply chains and the cutback in the Chinese credit impulse as we have previously written about. Consequently, while seasonal pressures might linger on energy and soft commodity prices, we are not overly worried about a prolonged rise in inflation as long as we do not see a considerable global wage pressure and since we expect supply chains reestablished over the next 12-18 months. Likewise, as the anticipated lower growth in 2022 remains above the growth average for the past many years and inflation while higher remains in the low single digits we do not see any comparison to the 1970 stagflation days as just. For now, the market seems to agree as longer-term inflation expectations seem somewhat anchored.

One of the known unknowns for the near-term future would be how the US FED reacts in terms of tapering and potentially monetary policy. Neither would normally be seen as good for EM although most EM countries have far better external balances than in the past and since quite a few central banks across EM have already started their own hiking cycles. The uncertainty to FED policy could however increase dependent on whether Jerome Powell will continue to lead the FED and whether this could lead to market jitter.

Outlook

While clouds have gathered over the past quarter, credit fundamentals for the broader EM universe appear robust still. While commodity producers remain large beneficiaries, pockets of EM HY will be affected by the pullback in liquidity as the wobbles in China have shown. Nonetheless, the global economy is moving ahead from the pandemic and eventually will be heading towards a normalization of the economy which supports EM overall. Given the multiple uncertainties, we suspect that credit selection will remain the main driver of alpha generation in the remainder of the year and maintain our tilt towards the better part of HY as we believe volatility structurally could increase. In such a scenario, we believe sticking to well-known issuers with proven longevity and track records remain our favored risk allocation as this should deliver the better risk/return profile in our view.

Kind regards,

Chresten Hagelund, Søren Bertelsen and Eduardo Ordoñez

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Last edited 30th September 2021.