For professional clients only

First State Investments

Quarterly Update | High Yield

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2Q 2018 | Co-Portfolio Managers: Matt Philo, Mike Elkins & Jason Epstein

RISK FACTORS

This document is a financial promotion for The First State High Yield Strategy. This information is for professional clients only in the EEA and elsewhere where lawful. Investing involves certain risks including:

- **The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.**
- **Currency risk:** Changes in exchange rates will affect the value of assets which are denominated in other currencies.
- **Credit risk:** The issuers of bonds or similar investments may not pay income or repay capital when due.
- **Interest rate risk:** Interest rates affect the value of investments; if rates go up, the value of investments fall and vice versa.
- **Currency hedged share class risk:** Hedging transactions are designed to reduce currency risk for investors. There is no guarantee that the hedging will be totally successful or that it can eliminate currency risk entirely.
- **Derivative risk:** The use of derivatives may result in gains or losses that are greater than an investment in the underlying asset.
- **Below investment grade risk:** Below investment grade debt securities are speculative and involve a greater risk of default and price changes than investment grade debt securities due to changes in the issuer's creditworthiness. In periods of general economic difficulty, the market prices may fluctuate and decline significantly.

Reference to specific securities or companies (if any) are included to explain the investment strategy and should not be construed as investment advice, or a recommendation to invest in any of those companies.

There are currently no investment funds available for this strategy in the EEA. Please contact your sales representative for more details.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

"Whenever you find that you are on the side of the majority, it is time to pause and reflect." *– Mark Twain*

Thoughts on the Market

Our Q4'17 commentary began:

"Barely one week into the new year, two of the most respected investors of investment grade "plus" fixed income publicly singled out high yield corporate bonds as a particularly poor investment. When respected peers make it a point to bash our entire asset class it would be worthy of reflection…if we knew why…"

As it turns out, the first half of 2018 was challenging for many financial markets in general, and many fixed income markets in particular. The following chart of total returns of various asset classes highlights many of these trends:

Table 1: Returns of Various Assets

Asset Class	1Q18	2Q18	1H18
S&P 500	-0.76%	+3.43%	+2.65%
US High Yield Corp Bonds	**-0.91%**	**+1.00%**	**+0.08%**
Leveraged Loans	+1.58%	+0.74%	+2.33%
10-Year US Treasury	-2.39%	-0.30%	-2.68%
Investment Grade Corp	-2.20%	-0.94%	-3.12%
Euro High Yield Corps	-0.48%	-1.21%	-1.68%
EM High Yield Corps	-0.44%	-3.26%	-3.68%
Emerging Market Stocks	+1.42%	-7.90%	-6.60%
US High Yield by Rating			
BB US High Yield Corps	-1.66%	-0.12%	-1.78%
B US High Yield Corps	-0.40%	+1.43%	+1.02%
CCC US High Yield Corps	+0.55%	+2.59%	+3.15%

Source: JP Morgan, ICE BAML

1Q'18 saw downside volatility in both global stocks and US Treasuries. Only U.S. Leveraged Loans were solidly positive. U.S. High Yield posted a -0.91% total return as its -2.4% price decline was greater than its income return. However, High Yield demonstrated its relative resilience to rising rates due to its current income advantage, and relatively short average duration. Among U.S. High Yield "rating tiers" CCC-HY generated a modest positive return, B-HY a modest negative and BB-HY noticeably weaker.

The 10-year UST bond declined -2.4% with two effects that would define fixed income markets in 2Q'18:

- A disproportionate sell-off in higher quality, longer duration market segments (e.g. high grade corporates),
- Inter-quarter weakness in Emerging Market Bonds.

In **2Q'18** U.S. High Yield was amongst the best performing asset classes (edging out Lev Loans), Investment Grade corporates experienced continued, albeit lessened weakness, and Emerging Market bonds (joined by Emerging Market stocks) experienced accelerated and meaningful sell-offs.

Fortunately, a steady stream of cautionary articles regarding the outlook for high yield continue; the comforting norm for seasoned high yield PM's. We'll be worried if we ever start hearing our own echo (as in our 4Q'17 commentary):

"We have yet to experience a market environment where our investment process can't identify a fully diversified high yield portfolio that overcompensates for estimated default risk; the current market posing no exception. Further, we don't fear market volatility or downside corrections; we calmly welcome the opportunities they present."

High Yield Market Commentary

The broad high yield market as represented by the ICE BofAML US Constrained High Yield index posted a +1.0% total return during 2Q 2018 (+1.6% from income, offset by -0.6% of price decline). U.S. High Yield bonds outperformed the JP Morgan Leveraged Loan index for the first time all year in June (and 2Q'18). The 5 & 10 year U.S. Treasury rate increases moderated so that 2Q returns were -5 & -30 bps, respectively. U.S. Stocks posted positive return in each month of the second quarter, an environment typically supportive to high yield bonds.

The quarter's major macro event in the financial markets was the relatively sharp decline in both Emerging Markets Debt and Equities. Historically, weakness in emerging markets is a technical challenge for developed market high yield because many large investors own both asset classes (e.g. Unconstrained Bond investors).

Net-net the positive fundamental backdrop for U.S. High Yield (solid earnings growth, fair value and low defaults) and strong returns for U.S. Stocks, more than offset any technical challenges presented by the sell-off in Emerging Market bonds and stocks.

One interesting side note:

At the end of 2Q'18 the U.S. Leveraged Loan market (as measured by BofA) is nearing the size of the U.S. High Yield Bond market (based on face amount outstanding): 1.05Tn versus 1.13Tn. This is remarkable in the context of recent years. At the end of 2013 the U.S. High Yield Bond market was 60% larger than the Leveraged Loan market.Over the past 4.5 years the face amount of High Yield Bonds has increased just 5%, while that of Leveraged Loans by an eye-opening +54%. At the same time, 82% of new issuance of leveraged loans YTD'18 have been of "covenant lite." It's not for this Commentary to review the relative merits of Leveraged Loans, but we observe much on which ***"to pause and reflect."***

Portfolio Positioning

May was the relative "soft patch" during the second quarter and presented opportunities to add select, higher yielding credit risk in the context of our disciplined investment process. Our weighting in the Healthcare sector increased nearly 2% relative to the index, primarily in the Pharmaceuticals sub-sector. The May temporary sell-off in the price of oil also led to a more modest increase in our Energy Sector weighting; also accretive to portfolio yields and spreads. In particular, Our Broad, Quality & Select Composites all ended 2Q'18 at modest yield-to worst (YTW)*, and spread-to-worst (STW)* premiums to Index Benchmarks (in contrast to modest discounts at the end of 1Q'18).

Importantly, issuer counts still reflects the historically narrow opportunity set presented by the current high yield market.

(See Analysis: Opportunity Set on page 4)

*Please refer to glossary on page 10 for definition

Composite Performance Summary

High Yield Composites - Annualized

June 30, 2018

	Q2 2018	Q1 2018	YTD	12 mths to 30/06/18	Since Inception May 1, 2017	AUM ($m)
Broad High Yield	**0.79%**	**-0.28%**	**0.50%**	**3.12%**	**3.73%**	**212.7**
ICE BofAML US High Yield Constrained Index	*1.00%*	*-0.91%*	*0.08%*	*2.54%*	*3.04%*	
Excess (a)	*-0.21%*	*+0.63%*	*+0.43%*	*+0.58%*	*+0.68%*	
Select High Yield	**1.18%**	**-0.06%**	**1.13%**	**3.69%**	**4.25%**	**71.4**
ICE BofAML US High Yield Constrained Index	*1.00%*	*-0.91%*	*0.08%*	*2.54%*	*3.04%*	
Excess (a)	*+0.18%*	*+0.86%*	*+1.05%*	*+1.15%*	*+1.20%*	
Quality High Yield	**0.60%**	**-0.39%**	**0.21%**	**2.85%**	**3.48%**	**141.3**
ICE BofAML BB-B US High Yield Constrained Index	*0.65%*	*-1.11%*	*-0.47%*	*1.85%*	*2.43%*	
Excess (a)	*-0.05%*	*+0.73%*	*+0.68%*	*+0.99%*	*+1.05%*	
Short Duration High Yield	**0.83%**	**0.28%**	**1.11%**	**3.00%**	**3.09%**	**51.0**
ICE BofAML 1-5 Yr BB-B US Cash Pay HY Constrained Index	*1.14%*	*0.14%*	*1.29%*	*3.08%*	*3.36%*	
Excess (a)	*-0.31%*	*+0.13%*	*-0.18%*	*-0.08%*	*-0.26%*	
Defensive High Yield	**0.66%**	**-0.22%**	**0.44%**	**2.93%**	**3.45%**	**192.3**
ICE BofAML BB-B US High Yield Constrained Index	*0.65%*	*-1.11%*	*-0.47%*	*1.85%*	*2.43%*	
Excess (a)	*+0.01%*	*+0.89%*	*+0.90%*	*+1.07%*	*+1.01%*	

For investors based in countries with currencies other than the share class currency, the return may increase or decrease as a result of currency fluctuations. Performance data is calculated on a net basis by deducting fees (a model fee of 45bps has been applied) from a gross of fee return. This is the fee which would be applied to a typical client. However, the fee paid by a particular client can be subject to negotiation based upon, for example, the size of the investment. Hence individual clients may pay fee which differs from the model fee performance shown. The internally calculated gross of fee return excludes all costs (e.g. custody costs), save that it does not exclude costs associated with buying or selling securities within the portfolio.

Analysis: “Opportunity Set”

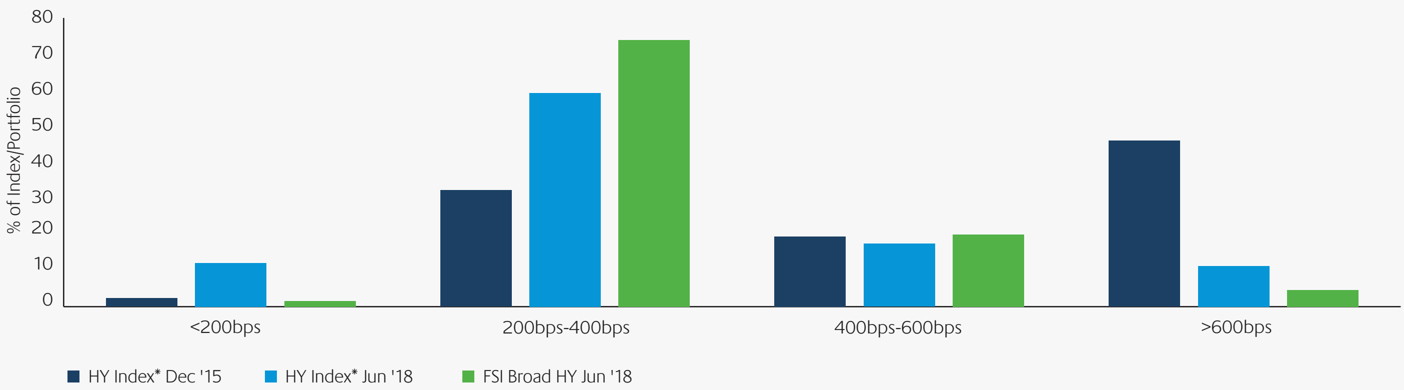
The most challenging high yield market dynamic continues to be the narrow opportunity set of high yield securities that we find attractive, based on our disciplined investment process. We can’t emphasize enough the severe challenge this dynamic presents to high yield managers with $10 billion, $20 billion or more in high yield AUM.

Even more importantly, this market environment is one where managers that “closet-index” or lack an effective and disciplined investment process are heading towards a reckoning that will, in our opinion, prove painful to disastrous for their investors. ***“Buyer Beware.”***

The following bar graph highlights:

1. The migration of credit spreads within the high yield market over the past 2 ½ years (since ~ the early- 2016 market low),
2. Our Broad High Yield Strategy “spread bucket” positioning versus the ICE BofAML US High Yield Index.

US High Yield Spread Migration vs. FSI Exposure %



*ICE BoAML US High Yield Master II

“Spread Buckets” (bps)

	600+	600 to 400	400 to 200	<200
HY Index* Jun'18 vs H0A0 Dec'15	-35%	-2%	27%	10%
Jun'18: FSI Broad HY vs. HY Index*	-7%	3%	15%	-11%
HY Index* Dec'15	46%	19%	32%	2%
HY Index* Jun'18	11%	17%	59%	12%
FSI Broad HY Jun'18	5%	20%	74%	2%

**ICE BofAML US High Yield Master II*
Source: ICE BofAML Bond Indices, Aladdin by BlackRock

1. At year-end 2015, 46% of high yield credits offered a STW > +600 bps versus just 11% at the end of 2Q ’18 (-35%). The majority of the offsetting spread migration has settled into the +200-400 bps & <200 bps “spread buckets.” The narrow “opportunity set” is represented by the 71% of credits offering STWs +400 bps or less (59% + 11%).
2. Our Broad High Yield portfolio ended 2Q ’18 with a YTW & STW modestly higher than the overall high yield market. It is interesting to observe the underweights in the “spread bucket” tails of 600+ bps & <200 bps (-7% & -11%). The offset to those underweights is primarily a 15% overweight in credits with STWs +200-400 bps. This positioning is what we would expect from our disciplined investment process in a high yield market where the average credit is near, or rich to fair value.

Analysis: A "No-QE World"?

"Saying is one thing and doing is another."
– Michel de Montaigne (~1580)

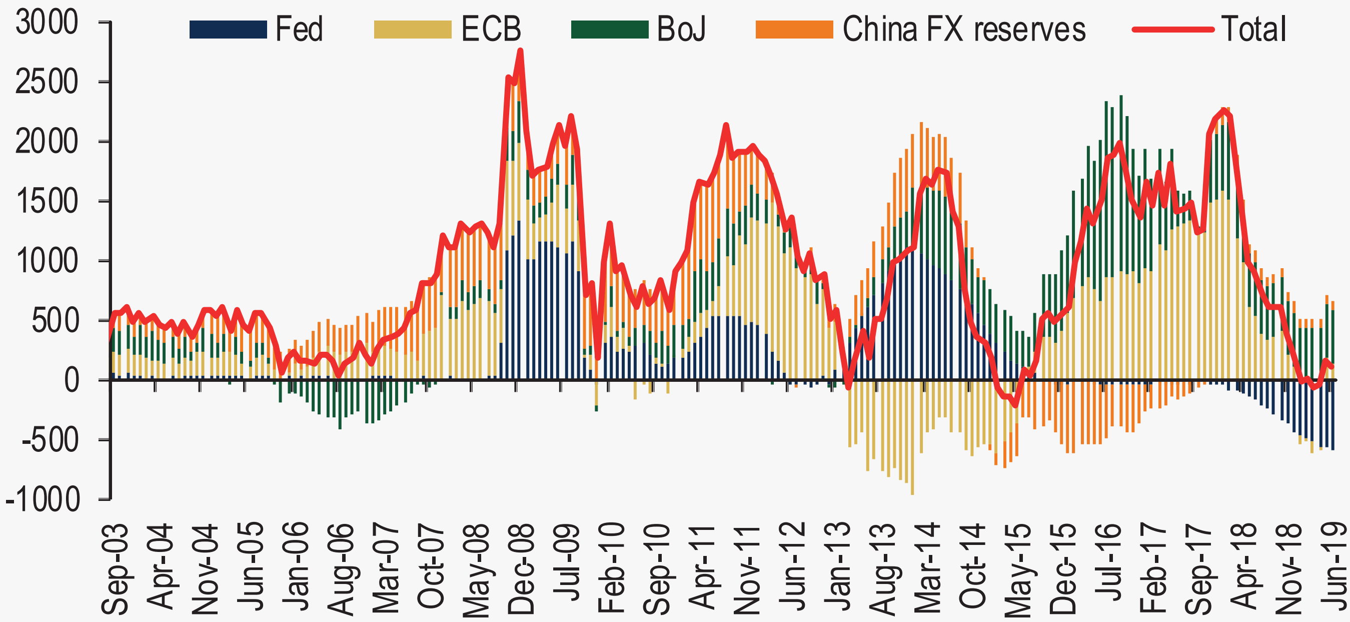
Market strategists and economic analysts continue to chatter about the upcoming "no-QE world."

We remain entirely skeptical based on our simple reasoning:

"In short, $15-20 trillion of stimulus injected directly into financial markets will not be methodically withdrawn regardless of the effects on global asset prices (the real "data" in former Fed Chair Yellen's term "data dependent")."

The following "Global QE" chart gives a great view of one data set of this century's extraordinary monetary experiment:

YoY changes in "Global QE". A decline already in '18 ($bn changes). Note we project until late '19.



Source: BofA Merrill Lynch Global Research, Bloomberg. YoY central bank balance sheet growth. Converting all numbers to $bn.

We can't speak to the data's accuracy but we dare make a simple observation: We seem to have been "here" before! The dark red line depicts points over the past 15 years when "cumulative Global QE" (***cGQE***) paused, or declined year-year. We see a recurring theme of "hot potato" amongst the four major global Central Banks:

1. 2006: The BoJ tightened monetary policy and year-over-year ***cGQE*** growth paused; but not for long as China (PBOC) stepped into the breach and aggressively bought foreign financial assets.
2. 2013: ***cGQE*** growth plummeted to turn briefly negative with a neutral Fed joined by the PBOC, BoJ and ECB. However, the Fed went on a buying binge along with the PBOC, and later joined by the BoJ.
3. 2015: Again, ***cGQE*** turned noticeably negative after the PBOC disappeared from the markets, the Fed steadily returned to neutral and the ECB remained negative. Another "never mind" after the Jan'15 unveiling of the ECB's "no vote necessary" €1.1tn QE program. That sent ***cGQE*** soaring yet again, especially once the ever aggressive BoJ "piled on."
4. 2018: Here in mid-2018, our "global worry list" is as long as usual: e.g. emerging market volatility, EU political uncertainty etc. Nevertheless, "this time is different" and a "no-QE world" is on the horizon? Not a chance in our opinion.

Fortunately the future of ***cGQE*** matters little to the ongoing implementation of our disciplined, fundamental investment process. ***"The game remains the same."***

Broad High Yield

Positive Contributors (top three):

Valeant Pharmaceuticals (VRXCN): Valeant bonds performed strong in the 2Q reversing its prior YTD negative contribution. Performance was driven in part by better than expected 1Q18 earnings and slight improvement to full-year guidance. The quarter included further capital market activity including secured and unsecured financings that continued to improve its debt maturity profile. The company also intends to change its name to Bausch Health Companies effective July 2018, signaling a fresh start for the company by leveraging the strength of its Bausch & Lomb global brand and highlighting the company's diverse lines of business. Valeant's company specific advances were supported by improved market sentiment evident across most of the specialty pharmaceutical sector. As such, Valeant's stock surged over 40% in the period providing meaningful benefit to its credit story.

Sprint Corp (S): The focus remains heavily on its merger with T-Mobile (TMUS) and Sprint bonds have been volatile at times as sentiment around the deals FCC and DOJ approval changes with frequent news in the market. Sprint's strong 2Q performance was largely obtained from our holding several specific bond issues that received out-sized cash payments in exchange for various consents to change certain bond covenants in order to facilitate the closing of the T-Mobile merger. At current spreads we believe Sprint offers a very attractive total return opportunity and remain more optimistic than the market of the merger's approval which is currently expected in 1H19. We expect price volatility to continue in the name as the situation progresses which will require added active position management.

EP Energy (EPENEG): EP Energy benefited from both industry-wide and company-specific catalysts in the quarter. On the industry front, WTI oil prices moved up from $63/bbl to $74/bbl in the quarter with continued positive momentum supported by OPEC regaining its credibility in managing global supply. In company-specific news, EP Energy completed a secured financing that paid down revolver and allowed the company to negotiate an extension of the revolver's maturity. We viewed this bond deal as attractive and participated in the new issue which subsequently traded well.

Negative Contributors (bottom three):

Altice International (ALTICE): Altice International bonds underperformed during the quarter after reporting disappointing 1Q18 results. Additionally, bonds were negatively impacted by comments from management that they may forego a sale of their Dominican Republic business if they are not satisfied with the bids they receive. A sale of the Dominican Republic business had been a key component of the company's deleveraging plan, and management's update ran counter to prior guidance that the business would be sold in 2H2018. Later in the quarter, Altice International announced an agreement to sell a 75% stake in its Portugal tower assets, with proceeds earmarked for debt reduction. We used that positive headline as an opportunity to reduce risk in the name.

Hughes Satellite Systems (SATS): Hughes, also known as Echostar Corp., underperformed in the 2Q as a result of its surprise bid to purchase Inmarsat PLC (ISAT LN). Over the past two years Echostar has built a $3.3B cash "war chest" earmarked for strategic M&A. Its large cash holdings have in part supported its credit profile but has also created a cloud of uncertainty. Echostar is considered a sister company to Dish Network (DISH) in which both companies are controlled by Charlie Ergen. While an Inmarsat merger holds attractive long-term commercial logic there are only minor immediate cost and revenue synergies. Investor anxieties were heightened by the many unknown's in an Inmarsat acquisition including its total cost and how associated financings would impact Echostar bondholders. We believe the bonds overreacted and used this as an opportunity to initiate a position in the company's 1st lien bonds. Subsequent to second quarter end, Echostar formalized its bid which was rejected by the Inmarsat board. Echostar bonds have begun to partially recover as near-term acquisition risk has dissipated.

Hertz Corp (HTZ): Underperformance was due to first quarter results which were below expectations, management's plan to maintain elevated investment spending in 2019 and continued investor concerns regarding higher fleet costs. We believe the second lien bonds remain well covered in the current capital structure with little debt ahead. The credit is further supported by adequate balance sheet liquidity, participation in a consolidated and rational industry experiencing positive end market demand and manageable near term fleet cost outlook.

Note:Securities discussed are the largest positive and negative contributors for the specific high yield strategy.

Select High Yield

Positive Contributors (top three):

Valeant Pharmaceuticals (VRXCN): Valeant bonds performed strong in the 2Q reversing its prior YTD negative contribution. Performance was driven in part by better than expected 1Q18 earnings and slight improvement to full-year guidance. The quarter included further capital market activity including secured and unsecured financings that continued to improve its debt maturity profile. The company also intends to change its name to Bausch Health Companies effective July 2018, signaling a fresh start for the company by leveraging the strength of its Bausch & Lomb global brand and highlighting the company's diverse lines of business. Valeant's company specific advances were supported by improved market sentiment evident across most of the specialty pharmaceutical sector. As such, Valeant's stock surged over 40% in the period providing meaningful benefit to its credit story.

Chesapeake Energy (CHK): Our Chesapeake loan and bond positions performed well in the second quarter due to a combination of factors. Q1'18 results outperformed expectations and positive cash flow from operations and asset sales allowed the Company to continue delevering the balance sheet. Additionally, investors are anticipating a larger asset sale at some point in 2018 which should continue the company's path of deleveraging. A supportive oil price environment (oil moving from $63/bbl to $74/bbl in the quarter) and market demand for CCC-rated credits also helped our positions during the quarter.

Tapstone Energy LLC (TAPENE): Tapstone Energy is a lightly followed issuer with only $300mm of bonds outstanding. We identified the issue as offering good relative value in the context of a supportive energy backdrop in the second quarter. In addition, the company's results broadly met the markets expectations for Q1'18. Additionally, market appetite for CCC-rated credits also lent technical support to Tapstone's bonds as investors' sought higher yielding ideas in order to benefit from positive industry fundamentals.

Negative Contributors (bottom three):

Titan Acquisition (HUSKYI): Titan Acquisition, also known as Husky IMS International, was a new issuer to the market in the second quarter of 2018 after Platinum Equity bought the company. We participated in the new issue for both the bank debt and the bonds. Later in the quarter, the company reported weak Q1'18 results which pressured loan and bond prices. We consider the loans and bonds to be attractive and believe improved earnings for the remainder of 2018 should be a positive catalyst.

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Quality High Yield

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EP Energy (EPENEG): EP Energy benefited from both industry-wide and company-specific catalysts in the quarter. On the industry front, WTI oil prices moved up from $63/bbl to $74/bbl in the quarter with continued positive momentum supported by OPEC regaining its credibility in managing global supply. In company-specific news, EP Energy completed a secured financing that paid down revolver and allowed the company to negotiate an extension of the revolver's maturity. We viewed this bond deal as attractive and participated in the new issue which subsequently traded well.

MEG Energy Corp (MEGCN): MEG Energy benefited primarily from company-specific catalysts in the quarter. Late in Q1'18, MEG announced the sale of its 50% ownership in the Access Pipeline for $1.5bn, which allowed the company to pay down term loan and put cash on the balance sheet. The company also announced new capital investment plans in Q2 in tandem with solid Q1'18 results. The combination of deleveraging and a continued sound management strategy resulted in MEG's bonds trading well during the quarter. Additionally, the stock price doubled during in the quarter which gave bond investors comfort in the value underpinning the debt.

Negative Contributors (bottom three):

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Hertz Corp (HTZ): Underperformance was due to first quarter results which were below expectations, management's plan to maintain elevated investment spending in 2019 and continued investor concerns regarding higher fleet costs. We believe the second lien bonds remain well covered in the current capital structure with little debt ahead. The credit is further supported by adequate balance sheet liquidity, participation in a consolidated and rational industry experiencing positive end market demand and manageable near term fleet cost outlook.

Note:Securities discussed are the largest positive and negative contributors for the specific high yield strategy.

Short Duration High Yield

Positive Contributors (top three):

Frontier Communications (FTR): Frontier performed well in the period after releasing better than expected 1Q earnings and provided modestly higher full year 2018 earnings and free cash flow guidance. Marginal improvement in the acquired Verizon assets and continued operating outlook were welcomed in the market. Our 2Q performance was enhanced by our active trading in FTR's hi-coupon unsecured bonds which outperformed following its 1Q earnings release early in the quarter. Our holdings remain diversified across the company's well covered 1st lien term-loan, new 2nd lien bonds and short dated unsecured bonds which are strategically important for the company to retire so it may have the necessary time to focus on its operating turn-around.

SM Energy (SM): SM Energy performed well in the quarter after releasing better than expected Q1'18 earnings. The company continues to make progress on its deleveraging plans with assets sales announced in 2018. Positive company news combined with a supportive energy price environment gave investors reasons to believe that SM would be able to refinance its shorter-dated maturities without much issue. As a result, our investments traded up in the quarter.

Valeant Pharmaceuticals (VRXCN): Valeant bonds performed strong in the 2Q reversing its prior YTD negative contribution. Performance was driven in part by better than expected 1Q18 earnings and slight improvement to full-year guidance. The quarter included further capital market activity including secured and unsecured financings that continued to improve its debt maturity profile. The company also intends to change its name to Bausch Health Companies effective July 2018, signaling a fresh start for the company by leveraging the strength of its Bausch & Lomb global brand and highlighting the company's diverse lines of business. Valeant's company specific advances were supported by improved market sentiment evident across most of the specialty pharmaceutical sector. As such, Valeant's stock surged over 40% in the period providing meaningful benefit to its credit story.

Negative Contributors (bottom three):

Hertz Corp (HTZ): Underperformance was due to first quarter results which were below expectations, management's plan to maintain elevated investment spending in 2019 and continued investor concerns regarding higher fleet costs. We believe the second lien bonds remain well covered in the current capital structure with little debt ahead. The credit is further supported by adequate balance sheet liquidity, participation in a consolidated and rational industry experiencing positive end market demand and manageable near term fleet cost outlook.

Diebold Inc (DBD): Underperformance from Diebold bonds in the quarter was driven by a poor Q1'18 earnings report. The company seems to be having trouble on a number of fronts, including a tough pricing environment, continued industry challenges, and the restructuring of the business in order to compete in the current market. Additionally, there has been some management turnover. We took the opportunity to sell our bonds shortly after results.

Brookfield Residential Properties (BRP): Underperformance was driven by combination of mixed delivery trends discussed during the first quarter earnings call and continued investor concerns regarding industry cost inflation, home affordability and sustainability of the housing cycle. We continue to view Brookfield's large land position, geographic diversity and large investment grade owner as distinguishing positive attributes. In this context, we believe the senior notes offer attractive relative value at current levels.

Note:Securities discussed are the largest positive and negative contributors for the specific high yield strategy.

Defensive High Yield

Positive Contributors (top three):

Sprint Corp (S): The focus remains heavily on its merger with T-Mobile (TMUS) and Sprint bonds have been volatile at times as sentiment around the deals FCC and DOJ approval changes with frequent news in the market. Sprint's strong 2Q performance was largely obtained from our holding several specific bond issues that received out-sized cash payments in exchange for various consents to change certain bond covenants in order to facilitate the closing of the T-Mobile merger. At current spreads we believe Sprint offers a very attractive total return opportunity and remain more optimistic than the market of the merger's approval which is currently expected in 1H19. We expect price volatility to continue in the name as the situation progresses which will require added active position management.

SM Energy (SM): SM Energy performed well in the quarter after releasing better than expected Q1'18 earnings. The company continues to make progress on its deleveraging plans with assets sales announced in 2018. Positive company news combined with a supportive energy price environment gave investors reasons to believe that SM would be able to refinance its shorter-dated maturities without much issue. As a result, our investments traded up in the quarter.

Valeant Pharmaceuticals (VRXCN): Valeant bonds performed strong in the 2Q reversing its prior YTD negative contribution. Performance was driven in part by better than expected 1Q18 earnings and slight improvement to full-year guidance. The quarter included further capital market activity including secured and unsecured financings that continued to improve its debt maturity profile. The company also intends to change its name to Bausch Health Companies effective July 2018, signaling a fresh start for the company by leveraging the strength of its Bausch & Lomb global brand and highlighting the company's diverse lines of business. Valeant's company specific advances were supported by improved market sentiment evident across most of the specialty pharmaceutical sector. As such, Valeant's stock surged over 40% in the period providing meaningful benefit to its credit story.

Negative Contributors (bottom three):

Altice International (ALTICE): Altice International bonds underperformed during the quarter after reporting disappointing 1Q18 results. Additionally, bonds were negatively impacted by comments from management that they may forego a sale of their Dominican Republic business if they are not satisfied with the bids they receive. A sale of the Dominican Republic business had been a key component of the company's deleveraging plan, and management's update ran counter to prior guidance that the business would be sold in 2H2018. Later in the quarter, Altice International announced an agreement to sell a 75% stake in its Portugal tower assets, with proceeds earmarked for debt reduction. We used that positive headline as an opportunity to reduce risk in the name.

Hertz Corp (HTZ): Underperformance was due to first quarter results which were below expectations, management's plan to maintain elevated investment spending in 2019 and continued investor concerns regarding higher fleet costs. We believe the second lien bonds remain well covered in the current capital structure with little debt ahead. The credit is further supported by adequate balance sheet liquidity, participation in a consolidated and rational industry experiencing positive end market demand and manageable near term fleet cost outlook.

Diebold Inc (DBD): Underperformance from Diebold bonds in the quarter was driven by a poor Q1'18 earnings report. The company seems to be having trouble on a number of fronts, including a tough pricing environment, continued industry challenges, and the restructuring of the business in order to compete in the current market. Additionally, there has been some management turnover. We took the opportunity to sell our bonds shortly after results.

Note:Securities discussed are the largest positive and negative contributors for the specific high yield strategy.

Glossary

Yield to Worst:

The yield to worst (YTW) is the lowest potential yield that can be received on a bond without the issuer actually defaulting. The YTW is calculated by making worst-case scenario assumptions on the issue by calculating the return that would be received if the issuer uses provisions, including prepayments, calls or sinking funds. This metric is used to evaluate the worst-case scenario for yield to help investors manage risks and ensure that specific income requirements will still be met even in the worst scenarios.

Spread to Worst:

The net difference between the percentage yields from the best-performing and worst performing classes of securities, calculated by subtracting the second from the first.

Co-Portfolio Managers: High Yield

Michael Elkins
Senior Portfolio Manager

Mike joined First State Investments in September 2016. He has 23 years of industry experience and has been managing high yield since 1997.

He was Portfolio Manager for Avenue Capital Group. Mike managed high yield bond and loan investments.

Mike was a High Yield Portfolio Manager at ABP Investments U.S. Inc. and helped ABP build its in-house High Yield capabilities. He was also a Portfolio Manager at UBK Asset Management.

Mike has an MBA from the Goizueta Business School, Emory University and a BA from George Washington University.

Jason Epstein
Senior Portfolio Manager

Jason joined First State Investments in September 2016. He has 17 years of industry experience.

He was a Managing Director with Oak Hill Advisors where he was responsible for managing a team of analysts covering a broad range of sectors.

Prior to Oak Hill, Jason was an analyst within investment banking at Credit Suisse First Boston where he was a member of both the Financial Sponsors and Technology groups.

Jason has a BS in Economics from The Wharton School, University of Pennsylvania.

Matt Philo, CFA
Senior Portfolio Manager,
Head of High Yield

Matt joined First State Investments in May 2016. He has 30 years of industry experience.

He was Executive Managing Director & Head of High Yield at MacKay Shields LLC.

He managed the Mainstay High Yield Corporate Bond Fund (MYHIX) from December 2000 through May 2014.

Matt has an MBA in finance from New York University and a BA from University at Albany SUNY. Matt is a CFA Charterholder.

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