TYRUS CAPITAL

GLOBAL CONVERTIBLE STRATEGY

STRATEGY REPORT | Q2 2021

"Twin Peaks"

June 2021

EXECUTIVE SUMMARY: TWIN PEAKS

"Every day, once a day, give yourself a present."

Dale Cooper *(Kyle MacLachlan)*, *Twin Peaks (season 1)*, drama by David Lynch and Mark Frost, CBS Television, 1990

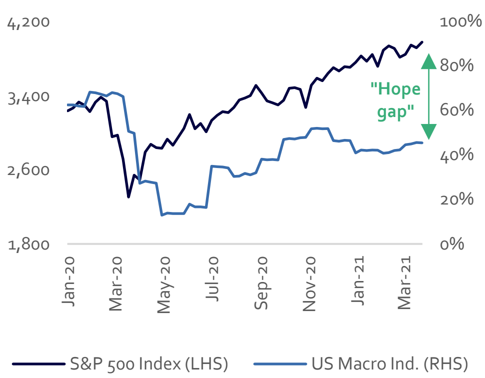
What has happened?

The global vaccination campaign continued in Q2, but progress was mixed across the main regions: the US saw vaccination rates fall dramatically while Europe made great progress in a reversal of fortunes and Asia (late to the game) started to pick up speed (although its vast populations will be a drag on uptake and lower efficacy rates of some of the home-grown vaccines may hamper momentum). Overall, however, data released during the quarter encouragingly showed that the **main vaccines: (a) are overwhelmingly effective against the variants; and (b) appear to have convincingly broken the link between infection rates and serious illness**. It cannot be stressed how monumental breaking this link is, as it shows clear success that vaccines have achieved their primary goal. High infection rates are not translating into high hospitalisations and deaths in countries that are well vaccinated. The question now is why some governments are reacting so drastically to infection rates when they should be shifting focus to serious illness. It is likely that this period will define which governmental approach will win and which will lose, with enormous repercussions for ensuing societal and economic outcomes. Libertarian governments that have the foresight to move forward will be rewarded, while overly cautious nanny states will remain in perpetual purgatory because it is quite clear that, like influenza and the common cold, this virus is not going away.

On the global political stage, not much changed in Q2: central banks continue to do more of the same, although the Fed's tone seems to have become slightly more hawkish. Turning to economics, more classical macro data saw another peak this quarter with impressive YoY GDP prints across the globe. Given the base effect, the overall size and timing of both fiscal and monetary stimuli mean that we are still in a concerted uptrend, but we feel that **the peak positive news cycle surrounding the fundamentals is now behind us in the developed markets (with the yet-to-be-announced Q2 spike in Eurozone GDP post relaxation of lockdown likely to mark the top).** While we will have new support plans (US child tax credit, infrastructure spending, etc.) in the coming quarters, the potential of having something as headline grabbing as what has been seen in the last year (e.g., USD 2trn American Rescue Plan Act of 2021) is limited. A measured view is further supported by pressure mounting from hawks (Republicans in the US and Germans in the Eurozone) already complaining bitterly about overexuberance and inflation.

Market momentum continued into Q2 led by equities, which finished up +7.2% and outperformed fixed income (bonds gained +2.5%). Inflation fears subsided as the US Treasury 10Y yield ended the quarter back below 1.5% – albeit not quite as low as the 0.9% level at the end of Q4 2020. This (a) helped bonds to rally after a tough Q1, and (b) fuelled a resurgence in growth stocks (although value stocks remain ahead of growth overall for 2021), momentum that we think will continue in the near term. The outperformance by growth was also responsible for helping **high yield ("HY") beat investment grade ("IG") bonds**. Despite this, while equities did get more expensive in dollar terms, they in fact cheapened slightly in terms of valuation multiple. Regionally, the US and Europe led equity gains as Asia was marred by Europe/US-favoured fund flows, Chinese regulation that spooked investors, and higher input costs that put pressure on margins. **The passing of fundamental twin peaks (vaccine and GDP) puts us in a strange position running into the summer with the positive headline zenith behind us but markets being already up double-digits YTD.** As

S&P 500 Index vs. Tyrus US macro indicator



shown in figure 1, the giant maw of "hope" between macro fundamentals and markets suggests there is even more pressure for this gap to eventually close. The trillion-dollar question is when will the pullback come and which unfortunate investors it will hurt most.

Our strategy performance

Our Tyrus Capital Global Convertible strategy delivered +0.3% in Q2 2021 (SI USD acc. Class), while keeping 90-day volatility low at 4.9%. Our performance was curtailed as: (a) convertibles underperformed equities (+1.6% vs. +7.1% for equities) due to sector bias and an adverse equity volatility headwind; and (b) we underperformed the convertibles benchmark (+0.3% vs. +1.6%) primarily due to the regional construction of our portfolio vs. the benchmark (more Asia and less Europe). Convertibles, however, remained cheap, which enabled us to take advantage of Asia's lower valuations to consolidate our holdings in the region.

Our view

Main focus: As mentioned earlier, progress on global vaccinations was mixed in Q2 following a slight reversal of leaders and laggards. After being one of the quickest to start, US vaccination rates have run out of steam after a dramatic fall in rates in Q2. Meanwhile, Europe appeared to have overcome the logistical problems that plagued its rollouts in Q1 to progress very well in Q2. Asia has lagged in vaccination rates but is now making steady progress. For us, this progress overall is clearly visible in economic data, where US data continues to hold ground, Europe's recovery has surprised on the upside, and Asia remains fundamentally strong but reserved.

All the rest: Global growth looks well supported as it appears that real inflation scares (headline CPI prints excluded) have subsided for now while continued monetary and fiscal dovishness remains in place. If US jobs return post furlough, then there is a real possibility of a savings-sponsored spending splurge, so employment developments are crucial to eyeball. Nonetheless, downside risks do exist. We feel that the likelihood of new COVID variants translating into a surge in hospitalisation rates is low where vaccination rates are high, but there is still risk around how governments handle the situation. A misstep (or more missteps...) could do a lot of damage economically. Other points to watch carefully include detail surrounding the infrastructure package from the US (and Europe) and potential weaknesses in data on the US front as stimulus news flow diminishes and furlough schemes are unwound. No matter how small the risk, a central bank policy error remains a possibility and would be most terrifying for markets (the most likely trigger of a significant drawdown in our view). Although it is more likely this error would come from the Eurozone than elsewhere (given the historical dove-hawk tug of war between Euro-area countries), there is always the chance that the Fed overreaches the other way.

Our base-case scenario

	US	EMEA	Asia
Short-term growth	✓	✓	✓
Long-term growth	✓	✗	✓
Policy support	✓	✗	✓
Main risk	Return to low growth	Low growth remains, tapering	Geopolitical, regulatory
Key points to monitor	Consumer confidence, structural package	Delta variant, ECB policy	China growth, FX
Key rotation	Cyclical vs. growth	ESG	China vs. China-ex
To avoid	High valuation stocks	Domestic Europe, HY (and IG)	Weak ESG

In our twin peaks world, markets are less likely to focus on big-picture macro (unless it is bad, of course) and more likely to focus on company-specific results. This means more single name related volatility spikes on news/results in a context of a still buoyant (complacent?) market, but not to the same extent as in H1 2021. Again, tactically quite interesting from a convertible standpoint as well as for equity long-short (which has already had a very interesting year).

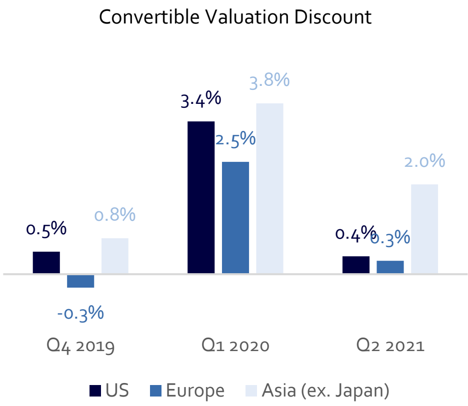
How are we positioned?

Taking the above foundational views into account, the question turns to how these events affect our five investment themes, portfolio positioning, and trading strategy looking forward:

	Contagion	Continue to favour US and Asian exposure while keeping our defensive stance on Europe and remaining underweight on the region. Will look to some cyclical winners and think growth will stage a relative comeback.
	Innovation in the US	We see pockets of value, namely technology (e.g., semiconductors) and healthcare. There are some cyclical/value winners that we favour, but we think growth will stage a relative comeback overall.
	Asian Century	We have significant exposure to Asia as we remain focused on the long-term drivers for the region and will therefore look to increase if compelling new issuances come to market. Our fixation on high quality and convex name selection should minimise any potential short-term regional pressures, as it has in the past.
	Cautious on Europe	We remain cautious on valuations and variant-associated risks. We still favour large cap and international plays, and we will keep an eye on spreads and inflation dynamics. It is difficult to benefit from growth in European convertibles.
AAA	**Quality Bias**	We favour quality names with IG profiles (or equivalent) over HY, strong focus on ESG, companies that are large and more international, and those that will benefit from domestic Asian growth. Favour yields in Asia rather than looking lower down the credit spectrum in the EU and US.

Where does this leave convertibles?

The current environment is very favourable for our asset class. Tactically speaking: the H1 pain in traditional fixed income, when convertibles were resilient vis-a-vis the rate moves, naturally led to some positive fund flows into the asset class. Likewise, a market where alpha becomes more important (natural evolution after the stimulus-induced beta rally in H1) and aligned with the earnings season plays well to an asset class that benefits from convexity and volatility. Active managers, especially, who have stock-picking acumen should shine. While the bias of the asset class toward innovative companies has not helped (apart from in June when it reversed) in the context of the value/cyclical driven rally in H1 (e.g., only one bank has a vanilla convertible outstanding in Europe), we expect the normalisation to address this gap by and large in the coming quarters.



Meanwhile strategically, it is key to point to the dynamism of the primary market this year as 2021 is shaping itself up to be an excellent vintage in terms of primary issuances. There has been a good balance between repeat issuers and newcomers with more attractive valuations than we saw in Q4 2020 due to the competition from the discounted secondary market. All of these factors contribute to solid market liquidity.

On this hopeful note, we wish our investors an excellent summer, hopefully without too many travel restrictions.

Best wishes,

D. Regnier

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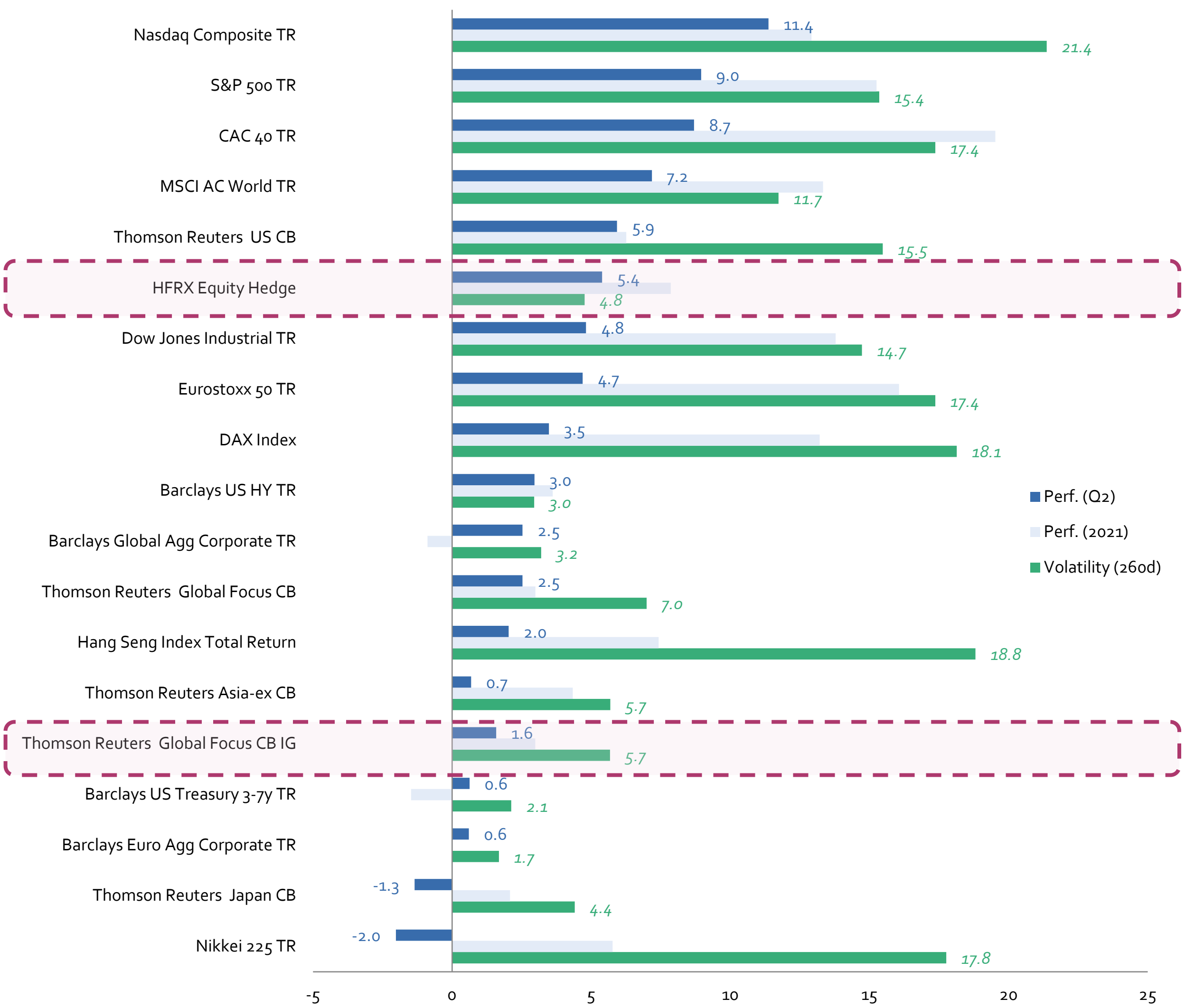
MARKET REVIEW

- **What has happened?** Optimism continued as the economic recovery pushed on, though the data suggest growth momentum for this cycle has likely peaked. Inflation concerns subsided (for the moment), which overall helped the market to extend gains.
- **Market summary:** US 10Y treasuries fell back below 1.5%. Volatility continued to fall. Equities finished up +7.2% in Q2, albeit still with variations among the main regions (US and Europe outperformed, while Asia Pacific lagged). Despite prices rising, valuation multiples got cheaper – but they remain expensive. Bonds gained +2.5% (but still down YTD) as HY beat IG.
- **Convertibles summary:** Primary markets remain buoyant while convertibles got cheaper. Convertibles underperformed the market in Q2 (thanks in part to lower equity volatility), but HY beat IG. In the context of this backdrop, our Tyrus Capital Global Convertible strategy delivered +0.3% in Q2 2021 (SI USD acc. Class).

What has happened?

Despite volatility and fixed income drag, equities finished up



Source: Bloomberg, as of 30 June 2021

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Market Summary

Risk-on! (!?)

If Q1 was asking interesting questions on topics such as inflation, US tax, and the long-term effects of COVID-19 for the economy, Q2 seemed to answer them with one word: upwards.

While headline macro indicators gave us compelling evidence that growth momentum for this cycle had likely peaked (not too hard when China and the US are boasting high single-digit growth figures) and authorities giving evidence vaccine rates had also peaked (despite the Delta variant incoming), bulls continued to dominate: HY outperformed IG, cyclicals shined, what was already expensive became even more expensive (at least in dollar terms) and what was fairly valued moderately ticked up further (except Japan and gold, which ticked down).

In terms of inflation, markets appeared to become less concerned with the topic as the US Treasury 10Y yield ended Q2 back below 1.5% – albeit not quite as low as the 0.9% level at the end of Q4 2020. This helped bonds rally after a tough Q1 (when the US Treasury 10Y peaked at 1.74%), although IG bonds remain down YTD.

The US tax question seems to have been partially answered in the form of a minimum global corporation tax floor. Post the G7 discussions and with a more benign read on inflation, the Nasdaq 100 Index is now back in line with the broader US equity market (+12.9% YTD) but still slightly behind the S&P 500 Index (+15.2% YTD). This move was captured by the US convertibles unconstrained index, but unfortunately less so by IG convertibles.

Markets were up overall in Q2 led by equities

Equities finished up +7.2% in Q2, outperforming fixed income (bonds gained +2.5% but remain down YTD). As inflation fears subsided, equities saw a resurgence in growth stocks (MSCI World Growth Index Total Return: +11.1% for Q2), which helped HY beat IG bonds. **Regional equity performance was however mixed:** while both the US (S&P 500 Index: +8.6%) and Europe (STOXX Euro 600 Index: +6.8%) gained, Asia lagged (MSCI Asia Pacific Index: +2.6%). In terms of valuation multiples, many will have missed the fact that **equity valuations got slightly cheaper** (less so for the more growth-oriented US markets), albeit they remain high overall:

Forward P/E Ratio

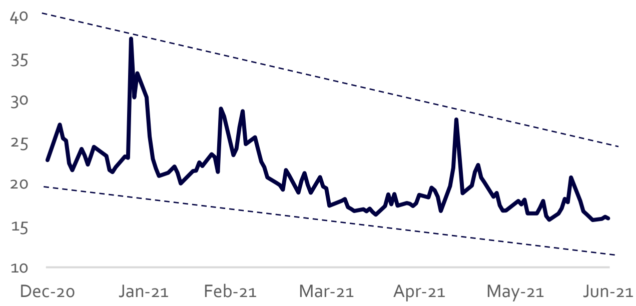
Index	Q1-end	Q2-end	Δ
MSCI Asia Pacific Index	18.3x	16.4x	-10%
MSCI Europe Index	17.5x	16.9x	-3%
S&P 500 Index	22.9x	22.7x	-1%

Source: Bloomberg, as of 30 June 2021

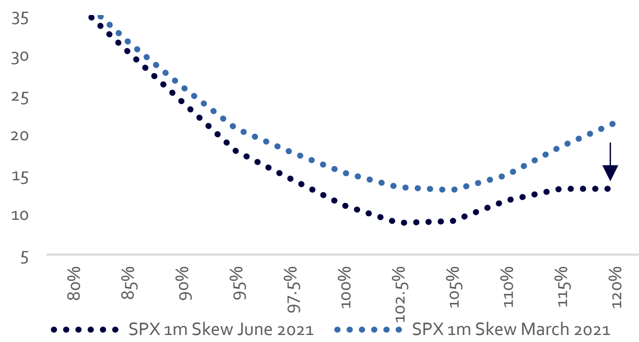
The fear index is not fearful. But not smiling either.

Unsurprisingly in this one-way market environment, equity volatility continued to ebb down with the VIX index ending Q2 2021 at 15.8 (down from 22.8 at Q4 2020, and 19.4 at Q1 2021). This downward move hurt convertibles and more generally anyone with long optionality. However, not all looks entirely bullish: observing the way the SKEW has diminished (i.e., out-of-the-money calls cheapening especially), it looks like investors are selling/capping upside thinking the market can go no further.

VIX Index



S&P 500 SKEW Index

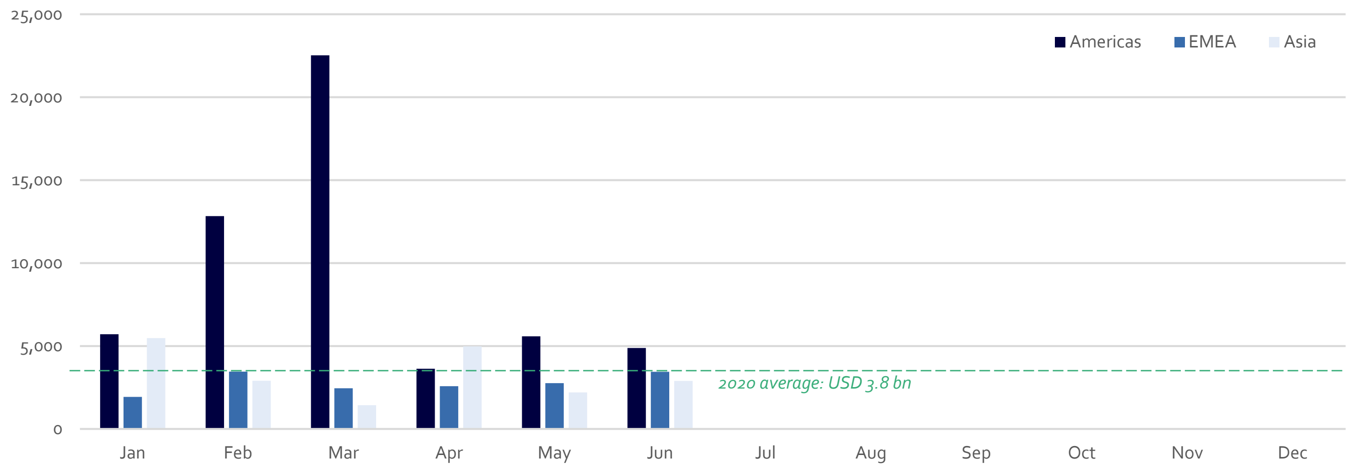


Source: Bloomberg, as of 30 June 2021

Convertibles Summary

Primary market remains very healthy

Primary market issuance by region (excluding Asian domestic), USD m



Source: Bloomberg, as of 30 June 2021

The momentum in Q2 continued for the primary market with USD 33bn added, bringing the total issuances YTD to USD 92bn. While last year was exceptional in many regards, 2021 is heading for another very good year for the asset class. Liquidity is set to be reliably improved for the coming years, with the only main downside, so far, being a bias towards HY companies as an inherited consequence of the pandemic.

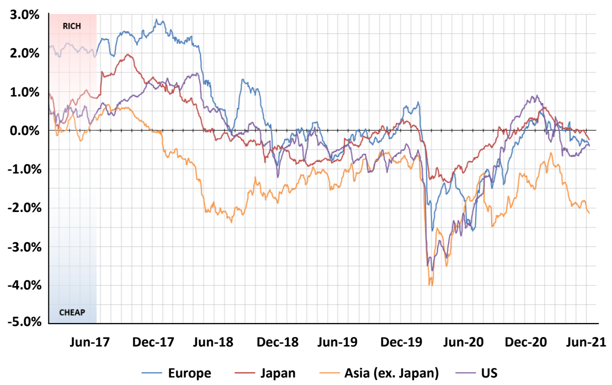
North America (predominantly the US) issued USD 14bn in Q2 2021. This is c.50% less than in Q2 2020, but circumstances are quite different now (i.e., significantly less emergency funding). Consumer discretionary, technology, financials, and healthcare (in that order) made up three-quarters of the 33 deals brought to market, with four of these deals above the USD 1bn mark (Etsy, Coinbase, Snap, and Splunk). Valuations were more reasonable than they were in Q1 as appetite was sated by the large supply of primary issuance in the past 18 months and attractive valuations on the secondary side. The high multiples on underlying stocks, however, remains. Looking at quarter-end, new deals performed well on average despite the volatility headwind.

EMEA added USD 9bn this quarter across 20 deals. Consumer discretionary led with 40% of the issuances and several "reopening" issuers: Tui AG, International Consolidated Airlines, Jet2 plc, WH Smith, and Norwegian Air Shuttle. The biggest issuance was in the energy space by Abu Dhabi National Oil for USD 1.2bn – a slight contrast to the more ESG-friendly trend we have seen over the past quarters. In terms of valuation, Europe had a similar pattern to the US as new deals were competitive given the attractive secondary market. As usual, index inclusion seemed to be a key short-term driver for Europe as it guarantees flows from the large domestic benchmark-following audience.

Lastly, **Asia added another USD 10bn in Q2 across 21 new deals,** including two deals of >USD 1bn (Meituan and Sino-American Silicon). Communication services led issuance from a sector perspective (mainly due to the Meituan deal), but the remaining deals were relatively well spread across the other industries. As expected, China dominated issuances in the region having been responsible for two-thirds of the total, with Japan and Taiwan following. Most new issues came in at the cheap end as the secondary convertible market in Asia is very cheap and alternative investors are more active in the region (versus Europe). Deals traded well on average. In Japan, most deals were issued in a typical fashion with an issue price of >100, but with a large volatility discount which made them also maintain their pricing level in the secondary market.

Convertibles got cheaper

Implied valuation of global convertibles



Source: Jefferies, 2 July 2021

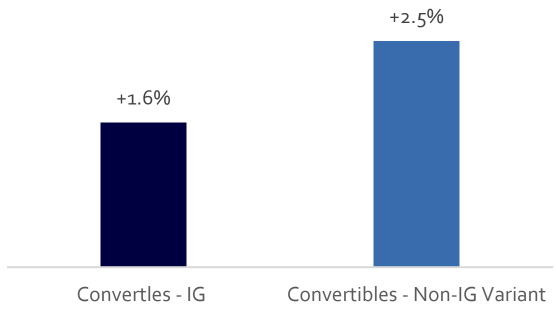
Valuations trended lower this quarter with a 0.5 – 1.0 point drop mostly taking place in April with the convertible implied volatility overshooting with a delayed effect from the move observed in options and shorter-term volatility indices (e.g., VIX Index) in March catching up, as well primary supply adding pressure to overall supply. Put a different way: short-term volatility went lower, longer-term (convertible) volatility got even cheaper, and liquidity continued to improve.

> ***Convertibles got even cheaper while their liquidity risk went lower due to new issuances***

This cheapening accelerated at the end of the quarter with the degree of cheapening varying across regions. Asia cheapened the most, finishing the quarter on average c.2 points cheap. This means Asian convertibles traded at 98, while their fair value based on long-term volatility and spread should be 100. This cheapness in Asia can be traced back to the lower proportion of Asian convertibles in the overly popular Refinitiv Global Convertible indices, a relatively good pipeline in 2021 in the primary market, and a stronger presence of alternative versus directional investors (worsened by momentum players) shifting toward Europe to chase the equity move.

Convertibles underperformed, but HY beat IG

Performance for long-only convertible benchmarks



Source: Bloomberg, 30 June 2021

While convertibles underperformed the market (please see our *Performance Review* section for more details), HY notably outperformed IG this quarter as was also the case in straight bond markets: the Refinitiv Convertible Bonds Global Focus Investment Grade Index (USD Hedged) returned +1.6% while the non-investment-grade variant version returned +2.5% (Refinitiv Convertible Bonds Global Focus Index, USD Hedged). The move was more pronounced on the tails:

- Credit-driven profiles that saw spread compression, especially on US names.
- Deep in-the-money names with a sector bias of HY issuers toward cyclical businesses and/or recovery stories from 2020.

To illustrate this move, a few distressed HY issuers that tapped the market in 2020 are now trading well above the 200 price point, e.g., Carnival, American Eagle Outfitter, and Callaway Golf. This situation typically occurs in smaller technology or biotechnology names.

INVESTMENT THEMES: CONTAGION

- **Our "Contagion" theme is centred around the COVID-19 pandemic and the impact it has on the world economy.**
- **What has happened?** Vaccinations continue but progress globally is mixed (US rates dramatically fell, Europe made great progress, Asia lagged but picked up speed). New variants remain a potential threat, but data show that vaccines (a) are effective against the variants, and (b) appear to have broken the link between infection rates and serious illness.
- **Our view:** Developed markets to continue their encouraging trend, but the peak positive news cycle is likely behind us. Vaccines should limit negative impacts from variants. Pressure grows for the macro-market gap to eventually close.
- **How are we positioned?** Continue to favour US and Asian exposure while keeping our defensive stance on Europe, remaining underweight on the region. In the absence of a household saving splurge, we think that much of the wind will be taken out of the cyclical rally's sails. There are some cyclical/value winners which we value on a name-by-name basis, but we think growth will stage a relative comeback overall.

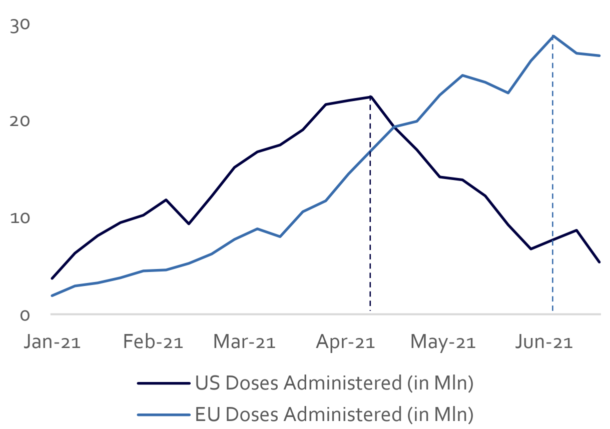
What has happened?

Vaccinations continue, but progress globally is mixed

The global vaccination rollout continued to gain momentum in Q2, but the picture was mixed for both developed and emerging markets.

In the developed markets, the US, who has been one of the flag bearers so far having been well ahead on vaccination rates, saw a dramatic slowdown in the number of doses being administered. Meanwhile, Europe's rollout gained traction after a slow start in Q1.

Vaccine doses administered weekly, millions



Source: Bloomberg, as of 30 June 2021

The US was initially on track to reach critical mass for vaccine-driven herd immunity by this summer, but after the rate of vaccinations drastically slowed in May and June, it is likely they now need another 5 to 6 months to achieve this target. There are several factors that might explain this unfortunate turn of events, which include the following: selection bias (those that were eager to get the vaccine have already done so), increased fear over potential side effects of Johnson & Johnson's single dose shot, problems with reaching more remote populations (major cities were targeted first in the rollout given population density), misinformation and lack of public education and delay of jab appointments due to proximity to holidays/reopening of travel (those that needed to take second shots within a certain time of the first coincided with recipients still being away on holiday and missing the window). Unfortunately, there also appears to be a large part of the population who are refusing to take the vaccine, who (ironically) arguably need it the most. Statistics suggest this group of people tend to be less educated, have lower incomes, are younger, or are part of ethnic minority groups. Nonetheless, it remains a challenge for authorities to convince these groups that it is necessary for them to get vaccinated to achieve critical mass and to limit the potential economic inequalities caused by the pandemic.

> ***Vaccination progress is slowing down in the US. Herd immunity now an end-of-year target.***

In continental Europe, the vaccine programme finally turned more positive as countries were able to address the supply and logistical challenges that plagued the region in Q1. As a result, an estimated 66% of the adults (18+ year olds) in the EU had received at least one vaccine dose as of Q2, up from 16% at the end of Q1 – an impressive turnaround. However, sentiment was mixed among the different member states as some countries showed signs of failing to find enough demand for the vaccine, which has led them to abruptly move down the age groups quicker than expected. For example, France saw demand from older age groups fall below expectations and had to open the vaccine to teenagers well ahead of schedule. By comparison, vaccine demand in the UK has been high such that the country had only moved to the <40 years old cohort in the same timeframe. However, this strategic decision by France is still a positive overall as the more doses administered, the better the coverage will be. On a sourer note, this does imply that a large percent of the vulnerable population (those that are 50+ years old and hence more likely to need the vaccine) are simply refusing to be vaccinated. While unpopular, measures such as vaccination passports or exemption from wearing a face covering for fully vaccinated individuals might provide incentives for the reluctant groups in the medium term.

Despite appearing to initially contain the spread of the virus better than their western counterparts, the emerging markets and Asia (including some developed countries such as Australia and New Zealand) have generally entered the vaccine rollout phase late. It is therefore no surprise to find these countries are behind in administration rates, albeit those numbers are improving and gaining momentum. On a more positive note, the country that was the cause of greatest concern in Q1, India, has seen restrictions, local lockdown measures, and their step up in their vaccine rollout finally bear some fruit: the number of daily cases fell from a peak of >400,000 cases in May to c.49,000 daily cases by the end of Q2. Unfortunately, given lower vaccination rates in Asia, the number of daily cases for the region is on the rise again as economies look to reopen and cross-border travel starts to be more flexible. This is a development that we are constantly monitoring, but as it stands, we feel the risk is controlled.

New variants remain a potential threat…

Although India appears to be controlling the spread of the virus internally (for now), the Delta variant first identified in the country and its new mutation (currently referred as "Delta plus") remain in the limelight on a more global level. According to PHE data, the base Delta variant is purported to be 60% more transmissible than the already highly contagious Alpha variant (first identified in the UK at the end of 2020).

The main variants of coronavirus

Country/region	Scientific name	WHO name
Kent, UK	B.1.1.7	Alpha
South Africa	B.1.351	Beta
Brazil	P.1	Gamma
India	B.1.617.2	Delta

Source: WHO, as of 30 June 2021

… but data show that vaccines are (a) effective against the variants …

The potential risks of the Delta variant led some countries to delay their reopening, such as the UK, where the variant was doubling every 11 days and appeared to be the main reason behind the sharp rise in daily cases in the country (other than the easing of social distancing measures) despite the high level of fully vaccinated people in the country. Studies in England have shown that having two doses from the AstraZeneca and Pfizer vaccines are respectively 92% and 96% effective against risk of serious disease and hospitalisation. However, protection levels drop off when it comes to stopping infection and therefore transmission (i.e., headline numbers) of the virus. On another, less talked about note, the less contagious Beta variant (first discovered in South Africa) appears to be well contained by both Pfizer's and Moderna's mRNA vaccines but creates more problems for AstraZeneca's vaccine to the point where AstraZeneca have developed a modified vaccine which is likely to be wheeled out in the form of a booster jab from September.

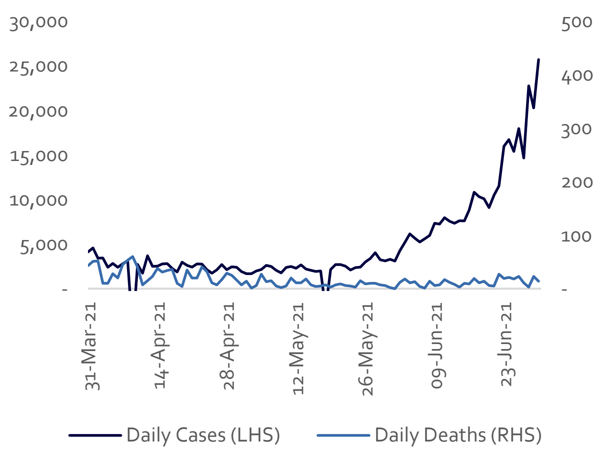
Delta variant is the greatest threat in efforts to eliminate COVID-19 in the US.
- Dr. A. Fauci (June 2021)

... and (b) they appear to have broken the link between infection rates and serious illness

If the focus for Q1 was vaccine administration, the focus on Q2 included to see how effective the vaccines were in terms of breaking the link between infection rates and serious illness (e.g., hospitalisations and mortality rates) – "putting theory into practise" so to speak.

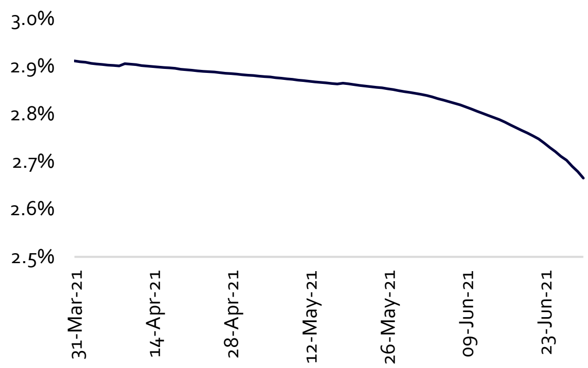
If we look at data from the UK (among the leaders in terms of larger-economy vaccine rollouts and a region where the Delta variant is become ever more prevalent), it is clear to us that the vaccines have so far shown signs of breaking this all-important link. As the graph below shows, we can see daily rates rise at the end of June when lockdown restrictions were lifted, but hospitalisations and mortality rates have continued to stay low (and significantly below prior waves). For the sake of simplicity, if we also compare total deaths as a % of total case counts (looking at daily case counts on its own in our view is invalid when a country drops all social distancing restrictions), we can see how this ratio dropped sharply at the end of June, further potential signs of the effectiveness of the vaccinees in preventing serious illness.

Daily COVID-19 cases vs. daily COVID-19 deaths in the UK



Source: Bloomberg, as of 30 June 2021

% of total COVID-19 deaths to total COVID-19 cases in the UK



Source: Bloomberg, as of 30 June 2021

However, it does take time for the data to reflect the real impact of the virus on the reopening of the economy. Therefore, if we use the post-quarter end/the most recently available data at the writing of this report, we can see that even though daily counts have continued to rise rapidly (expected given the reopening of the economy, lifting of restrictions, and spread of the Delta variant), the mortality rate has indeed continued to stay low as the total death-to-count ratio has continued to fall sharply. While we are not out of the woods yet, this does at least give us some hope.

Our view

Developed markets to continue encouraging trend but peak positive news cycle is likely behind us

With high vaccination rates in developed markets (UK and US in particular), where global news coverage tends to focus more, it is our view that positive vaccine news in these regions has likely peaked and will plateau or diminish from here (albeit negative news should be limited). Meanwhile, in emerging markets and Asia, the situation is different given their vaccination programs by comparison are further behind, so we could potentially expect more positive headlines going forward. However, given their sizes of population, it is unlikely that these regions will hit similar vaccination rates as developed markets until at least 2022 and beyond. For example, India has so far fully vaccinated c.80 million people, but this only equates to c.6% of its population.

Vaccines should limit negative impacts from variants

While the Delta variant has the potential to delay a global reopening of economies (a source of disappointment in a market priced for perfection), its ability to cause severe economic damage is drastically lowered by the available vaccines that have so far shown to have positive effectiveness against the strain in question (e.g., effective hospitalisation rates as mentioned above). We therefore feel it only poses a modest threat for Western economies with data suggesting that even if the vaccine rollouts were incomplete, pressure on hospital beds and the risk of further lockdowns should at least reduce by 33% to 50%. In our view, this rationale is not applicable in those countries and regions where vaccine coverage is far lower or where there have been fewer infections and hence much lower natural immunity. We will continue to keep an eye on the situation, but as it stands, we have limited (if any) portfolio exposure to these countries (e.g., India, Australia, Indonesia, and Vietnam).

While there has yet to be any sign of a new variant that is both strong and resistant to the vaccines (Beta is only resistant to AstraZeneca but not strong enough to dominate), we feel it is likely that an end to all restrictions by year-end for Western economies is still in play.

Global growth forecasts are raised again…

OECD's GDP growth forecasts

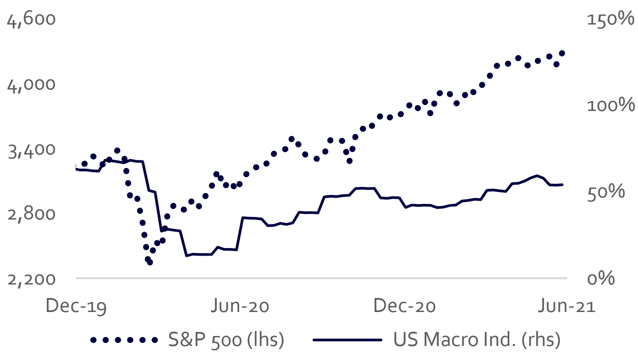
%	2020	2021	2022
World	-3.5	5.8	4.4
China	2.3	8.5	5.8
Euro area	-6.7	4.3	4.4
Japan	-4.7	2.6	2
United Kingdom	-9.8	7.2	5.5
United States	-3.5	6.9	3.6

Source: OECD, as of 31 May 2021. Note: Green = revised up, orange = revised down

Turning our attention to the global economic recovery, the latest data show that growth and economic forecasts have again been revised upwards for 2021 and 2022 following the last round of fiscal stimulus from the US. However, in the context of a market priced for perfection, there are some wrinkles in recent data releases that have also been picked up by our macro indicators.

… as the macro-market gap remained

Macro vs. Market: US



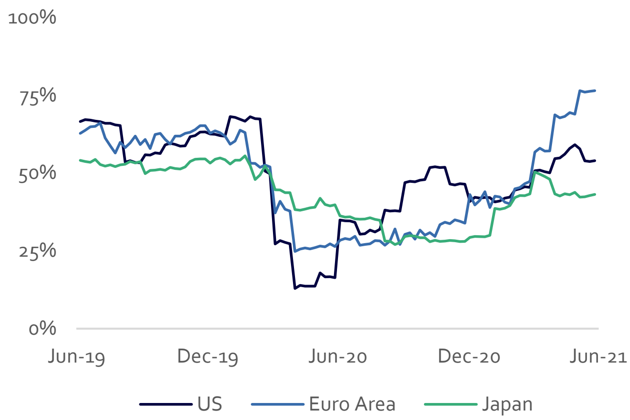
Source: Tyrus Capital, as of 30 June 2021

We have previously pointed to the sizeable gap between where macro indicators and markets are after markets recovered 5x faster from their March 2020 drop than their 1987 equity crash. This is especially apparent now in US data. As we have passed the peak when it comes to GDP headline prints post relaxation of most lockdown measures and injection of huge fiscal stimulus, we find ourselves in a state of more exposed disequilibrium. Although the underlying economic landscape is still largely healthy, we would have hoped our macro indicators (consumer confidence especially) would be higher. Except for a savings-led household spending spree combined with a healthy employment recovery post furlough (a necessary condition which we are monitoring carefully), we think that at these high levels the surprise in economic momentum will most likely show itself on the downside. For us, this all means that asset prices would at a minimum display higher volatility or would have to consolidate further and wait for earnings/macro uplift to advance further.

While momentum for some US and Japanese economic data looks to be flagging versus Europe, Q2 2021 saw a strong positive re-rating of Europe's macro indicators (despite limited feedthrough into GDP headline numbers thus far). This was mostly driven by consumer confidence, especially from

Southern Europe (e.g., Italy) with the progressive end to their lockdowns.

Regional macro indicators



Source: Tyrus Capital, as of 30 June 2021

We would, however, look at this through a lens of caution: the US had a similar burst of confidence in late Q4 2020 which then quickly flattened. Still, the move is quite strong, with this rebound most probably being explained by a wave of relief after such tough lockdowns in much of Europe – maybe genuine "revenge spending" could come from Europe (which could benefit China indirectly and the US as their main provider) after all.

Europe macro uplift driven by a burst of consumer confidence, especially in the South

How are we positioned?

What did we do this quarter?

We said in our last review that we favoured Asia and the US and would keep a neutral sector weight. Given new macro data and where valuation levels are for both equities and credit, we increased our exposure to Asia, which is relatively cheaper for both convertibles and the underlying stock. However, to increase our Asian exposure, we slightly reduced our overweight US and underweight Europe positions.

What will we do next quarter?

Our main outlook bias

	Overweight	Underweight
Region	US, Asia	EMEA
Sector	Healthcare (Asia), Communication Services (Asia)	Oil & Gas (EMEA), Consumer Staples (US)

Source: Tyrus Capital

From a regional perspective we continue to favour Asian and US exposure and remain underweight EMEA. In terms of US sectors, we favour those that will continue to benefit from a cyclical upswing/reopening of the economy but remain attractively priced on a name-by-name basis (a rare commodity). However, we still think growth will stage a relative comeback overall.

Despite peak growth and vaccination rates headline momentum dropping off at the end of the quarter, we expect the underlying US recovery to continue as macro indicators grind higher. The Delta variant presents a risk, but with recent studies suggesting positive vaccine resilience, this risk in our view is marginal.

In Asia, the variant potentially presents more of a risk given lower vaccination rates across the region. However, we remain bullish given encouraging economic data and upside and the fact that the region remains the most attractively priced. We will keep an eye on how the variant(s) impact the continent, especially as we still do not know how effective China's Sinovac vaccine is to the Delta variant (not to mention that it in general has less efficacy than the vaccines of Pfizer, Moderna, and AstraZeneca).

Despite some success in their vaccine programs and improved macro data, we will keep our defensive stance on Europe and remain underweight on the region. We expect the variant to spread further across the region this quarter and feel Europe remains economically fragile to the potential introduction of new lockdown restrictions. Breaking the link between infection and severe illness is crucial, and economic success will be determined by how governments react to the evolving data (with divided camps already emerging on whether to follow infections or hospitalisation/deaths more closely).

What if we are wrong?

Downside risk: Elevated stock valuations and tight credit spreads are always a concern. They are even more of a concern when fiscal stimulus effects are waning and tapering discussions are around the corner. If we then add a renewed round of variant-related restrictions in Europe in late Q3 into the mix, then we have the foundations for a sharp sell-off. As we use mostly investment-grade convertibles, apply discounted profiles and have a neutral sector composition, we are confident that we would weather such a storm well.

Upside risk: Revenge spending from the US consumer (especially against the backdrop of low consumer confidence) is the real known upside risk. A new round of fiscal stimulus could be on the cards, but given the negotiation of the tax-package we see this as less likely in the US. Central banks seem to be more cautious about upside risk too, so if anything, such a scenario leading to more outperformance of cyclicals would likely be cooled down by tapering discussions. So far, we do not see a sector repositioning argument that is justified by the data. However, if there is any equity upside from this (especially in Europe), we are likely to only be able to participate in part due to our investment grade and ESG biases.

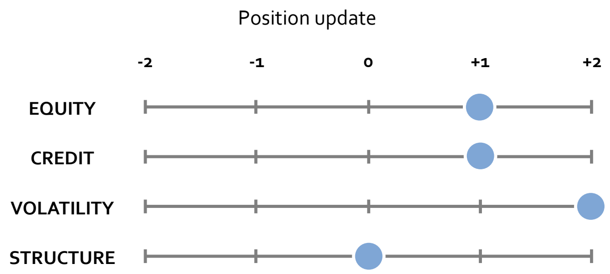
Exposure in this theme:

Southwest®

Bond held: Southwest Airlines Co 1.25% 2025

The airline was established on 15 March 1967 by Herb Kelleher as Air Southwest Co. and adopted its current name, Southwest Airlines Co., in 1971 when it began operating as an intrastate airline within the state of Texas (first flying between Dallas, Houston and San Antonio). The airline now has nearly 60,000 employees and operates about 4,000 departures a day during the peak travel season.

Southwest is one of the rare airlines to be both in the convertible space and have an official investment grade rating (rated BBB by S&P). It also happens to be above the hurdle of our "Best-In-Class" ESG rating thanks to better (and improving) metrics versus peers. It was one of the core names acquired to gain exposure to the reopening of the US economy.



Source: Tyrus Capital, as of 30 June 2021

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

臻鼎科技 Zhen Ding Tech.

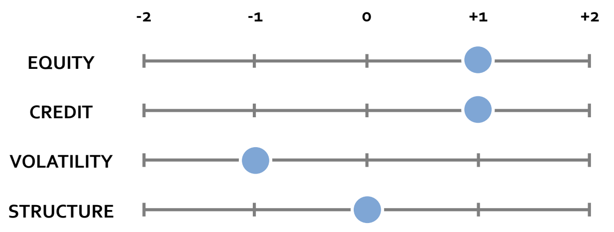
Bond held: Zhen Ding Technologies Holdings Co. 0% 2025

Zhen Ding is a Taiwanese listed semiconductor manufacturer that produces printed circuit boards and markets these products in China, where they are integrated in various supply chains with key customers including Apple, Huawei, Microsoft, and Dell.

The company has good ESG metrics (note they received awards from Apple in 2018 and Microsoft in 2019 for supplier of "outstanding environmental awareness and initiatives" and are also a member of Taiwan's Corporate Governance Top 100) and have a net cash position on the balance sheet. Along with these positive considerations, we selected Zhen Ding to gain: (a) direct access to global growth through a company with Tier 1 end clients; and (b) exposure to the semiconductor industry, which is central to most products from consumers electronics, cars and large machinery.

With an early redemption option in 2023, the convertible allows us to have a resilient floor while being at the sweet spot in terms of convexity thanks to its balanced delta, which will allow us asymmetric upside participation in case global growth strengthens more than expected this year.

Position update



Source: Tyrus Capital, as of 30 June 2021

INVESTMENT THEMES: INNOVATION IN THE US

- **Our "Innovation in the US" theme is about investing in American companies on the innovation frontier.**
- **What has happened?** GDP growth continues but YoY peak print behind us, supported by stimulus (part 2 of March's stimulus package incoming: child tax credit). Macro indicators improved but have yet to reflect economic tailwinds. Stimulus helped usage recover, but with unintended consequences on asset and commodity prices.
- **Our view:** We view inflation as transitory as prices rose and then fell. With the large swings in market sentiment and large moves in equities, style-wise momentum and value disappointingly seem mutually exclusive in our scorecard.
- **How are we positioned?** Despite overall economic health, the fact that we are past the twin peaks of headline GDP growth and the vaccine take-up means markets are precarious. We still see pockets of value within some sectors, namely technology (e.g., semiconductors) and healthcare. There are some cyclical/value winners which we value on a name-by-name basis but still think growth will stage a relative comeback overall. This approach should offer protection in this environment.

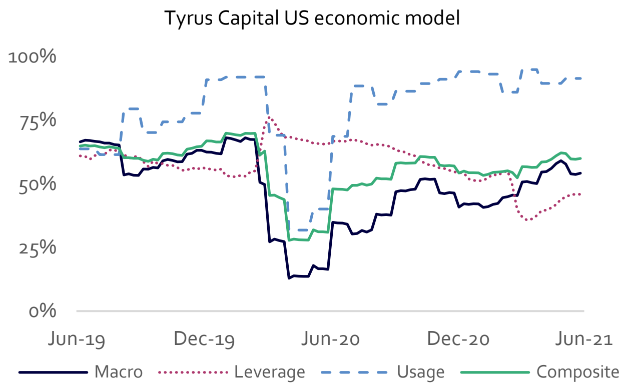
What has happened?

GDP growth continues but peak print behind us

Source: Hedgeye, 2018

Thanks to both a series of unprecedented fiscal stimulus and a positive base effect, the US will likely report its biggest YoY GDP growth figure in Q2 2021 in years. Further stimulus is about to land in the form of child tax credits as part of the American Rescue Plan Act of 2021 (whereby families across the country will receive up to USD 3,600 per child under 6 years old and USD 3,000 for 6-17 year-olds over the next 6 months). The potential for a fourth round of stimulus cheques is also rumoured to be being discussed in the capitol; however, we feel the probability of more stimulus being approved in the near term is unlikely given the momentum of the US recovery thus far, pre-existing rounds of stimulus, the repercussion of this on a tax plan, and the fact that it would be politically difficult to keep the more centrist Democrats from turning their backs on another round given concerns around inflation that emerged during the first part of this year.

Macro improving, but yet to reflect economic tailwinds



Source: Tyrus Capital, Bloomberg as of 30 June 2021

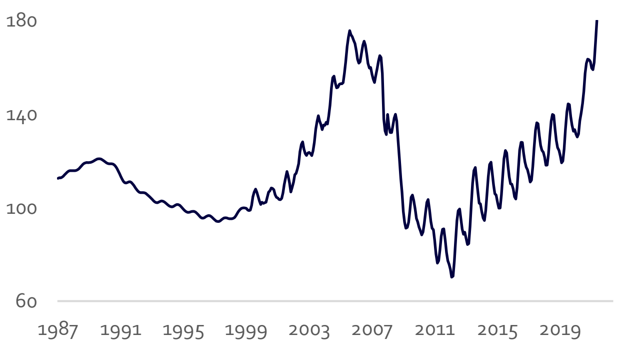
The Biden administration's economic gamble has been to use massive fiscal stimulus to maintain consumption (i.e., usage), while the vaccine is rolled out and the economy is reopened to enable a sustainable recovery. This is something our US economic model above shows, with the composite reading remaining quite flat over the last three quarters. That said, we are concerned that the fiscal stimulus that has been passed so far has used a lot of political ammunition. This leaves a question mark over whether the more structural components of legislation (e.g., infrastructure package, reforms, etc.) needed to propel the macro element higher will actually be passed.

This approach to dealing with COVID-19's impact on the economy has turned the normal economic cycle pattern on its head and has led to a unique cycle pattern this time around. **To understand why this cycle is unique, it is worth comparing this pandemic cycle to a normal one:**

Phase	Normal Cycle	COVID-19 Cycle
1. Initial economic shock	Macro impulse -ve (unemployment, confidence)	Macro impulse -ve (unemployment, confidence)
2. Economic fallout	Usage impulse -ve (spending, construction)	Usage supported through public stimulus
3. Leverage drop	Leverage impulse -ve (loans, house prices)	Leverage impulse -ve (but through debt pay down not tightening conditions)
4. Economic feedback of leverage and usage	Macro, usage and leverage -ve feedback	Macro and leverage -ve feedback but not usage
5. Economic recovery	Usage rebounds, then leverage, then macro	Usage already high, so leverage and macro expected to rebound

Stimulus helps usage recover, but with unintended consequences

US House Prices Index (cycle adjusted)



Source: Tyrus Capital, Bloomberg as of 30 June 2021

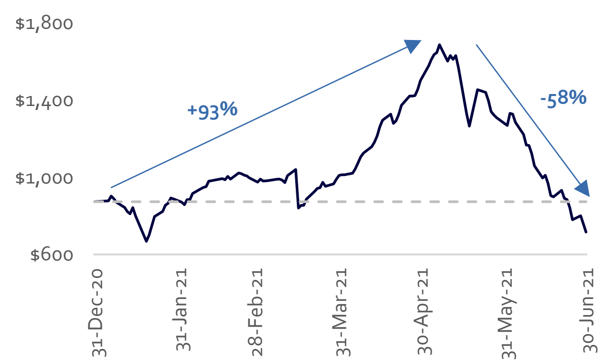
While the use of stimulus has achieved the goal of helping usage levels to recover quickly (see "Tyrus Capital US economic model" chart above), it has also had some unintended consequences for financial markets, such as retail traders speculating on meme stocks and the spike in cryptocurrency prices. House prices have also been affected with the US House Price Index returning to peak levels last seen just before the Great Financial Crisis of 2007/08 – we note the approximate doubling of lumber prices accompanying this rise (see graph on the right).

Our view

We view inflation as transitory, despite prices rising and then falling

Given it was the main topic in Q1 2021, it is important to revisit the concept of inflation, especially as it became less of a concern after US treasury yields fell back to more reasonable levels this quarter: US 10Y treasuries ended Q2 back below 1.5%, while the 30Y treasuries moved down to 2.1% (from nearly 2.5%). Yes, much of this was because of the liquidation of losing inflation positions, but this nevertheless still results in the same end effect for long-term interest rates. We continue to hold our view that inflation is transitory and will point to several points of reference below which support this view.

YTD lumber futures, USD per thousand board feet



Source: Bloomberg as of 30 June 2021

We would like to re-iterate our view that inflation really is transitory, but that does not mean there will not be bumps in the road along the way. Indeed, we have seen some alarming CPI prints (Core CPI: April +0.9%; May +0.7%; June +0.9%), concerns from Congress in the US and claims that consumer confidence is being impacted by fears of rising prices. However, there are reasons to be more sanguine on the topic. Firstly, several commodity prices rose sharply in the first part of the quarter, but then retreated from those highs, such as timber prices (see chart above). Iron ore and copper are also other good examples that followed this trend, although prices for them remain up YTD (unlike timber). Secondly, and part of the reason for these commodity prices coming down is that supply side constraints are showing signs of easing. This should start to feedback into headline CPI numbers and consumer confidence.

Technology back on top, but still expensive

S&P 500 index scorecard

	Momentum	Technicals	Earning Trend	Sentiment Trend	Relative Value
Info. Technology	7	2	1	1	11
Financials	1	8	3	2	5
Energy	4	4	9	9	2
Real Estate	8	1	7	8	6
Comm. Services	6	5	6	6	4
Health Care	9	3	5	7	8
Industrials	5	7	4	5	9
Materials	3	11	2	4	7
Cons. Discretionary	2	6	8	3	10
Cons. Staples	10	9	10	10	3
Utilities	11	10	11	11	1

Source: Internal Calculations, Bloomberg, as of 30 June 2021

With large moves in both market sentiment and equities, our scorecard results saw consumer discretionary drop from the top third into the bottom third of our rankings as a lot of names reached and breached their valuation targets. Meanwhile, technology returned to top spot thanks to semiconductors, telecommunications equipment, and interactive media. Financials dropped one spot but were helped by consumer finance and real estate management.

How are we positioned?

What did we do this quarter?

In line with our fundamental compass, we slightly reduced our exposure to the US in Q2. This adjustment was done gradually with names that reached internal price targets being sold in a disciplined manner. With limited attractively valued candidates available in the region, we either held these proceeds as cash or favoured cheaper valuations in Asia.

The slight reduction in US weighting does not by any means reflect a lack of positivity over our "Innovation in the US" theme. It is more to do with fact that we were unable to rotate funds into new portfolio positions as it is difficult to source names that have acceptable equity valuations right now. We would consider slightly higher underlying equity multiples if the convertible profile is discounted and offers decent convexity. Alternatively, we would be content with a fair convertible profile with fair or discounted underlying stock valuation. What we are avoiding, of course, are underlyings with overly expanded multiples and a slightly expensive convertible profile.

What will we do next quarter?

Our main outlook bias

	Overweight	Underweight
Country	US	n/a
Sector	Technology, healthcare	Consumer staples, utilities
Trading Style	n/a	n/a

Source: Tyrus Capital

Despite economic expansion in the US, we are concerned how markets are priced given that the twin peaks of headline GDP growth and the vaccine take-up are behind us.

Looking at technology, we still see regulatory reform (e.g., tax and antitrust developments) presenting a risk for the sector, particularly for the big internet and software names (which also happen to trade on very high multiples). We do, however, believe there is better risk/reward in the semiconductor space and will look to add exposure here, especially through more balanced convertible profiles. Healthcare is another sector where we would like to grow our exposure given its low dependency on wider market growth. This idiosyncratic nature protects from potential market headwinds in the coming quarter in this sector as stimulus effects potentially start to fade.

What if we are wrong?

Downside risk: At 50-55% population coverage for the vaccine (ignoring natural immunity from infection), the US in theory should not see new extensive lockdowns, but instead might see more delays in the economy achieving a return to normality. With high valuations and pressure on the Fed to navigate a safe passage, we see the biggest risk as being a policy error or misstep, and not inflation. In that context, a Q4-2018-style correction would be a very probable outcome – our focus on investment grade and convex profiles would protect us here.

Upside risk: Aside from a dramatic improvement in herd immunity statistics (from enforced vaccination programs or possibly an underestimate of natural infection immunity), we think that the major upside risk would be from a savings deployment combined with improving consumer confidence. This would benefit high beta and cyclical names. Should there be further pressure on the yield curve (good for growth stocks), our strategy may lag slightly given our reluctance to gain exposure to overvalued equity underlyings, but we nonetheless should still benefit. We would rather face the risk to continue to lag on the upside than expose ourselves to a significant de-rating should the downside scenario materialise.

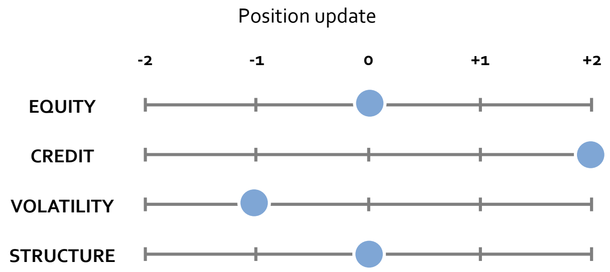
Exposure in this theme

Bond held: Palo Alto 0.75% 2023

Palo Alto Networks is a global leading enterprise cybersecurity company. Through organic growth and M&A, the company is a market leader in on-premise firewalls and has built a leading next generation security platform focused on network, endpoint, and cloud security. They provide enterprise solutions via a mix of products and subscriptions to >50,000 customers in >150 countries across multiple industries.

Palo Alto Networks is one of the best companies to play the cybersecurity trend as the sector gears up for sustained growth as enterprises increase their security spending and shift focus from on-premise to cloud. As the number of cyber-attacks continue to gain traction (e.g., Colonial Pipeline, Microsoft, Adobe, etc.) and as more employees shift to remote working, the need to protect data and systems is becoming critical to even the most basic of company's infrastructure.

We have been long-term investors in Palo Alto Networks and have benefited from the business having one of the best credit profiles within the cybersecurity convertible universe. The company has a good focus on ESG and recently became an affiliate member of the Responsible Business Alliance, the largest industry coalition dedicated to corporate responsibility in supply chains.

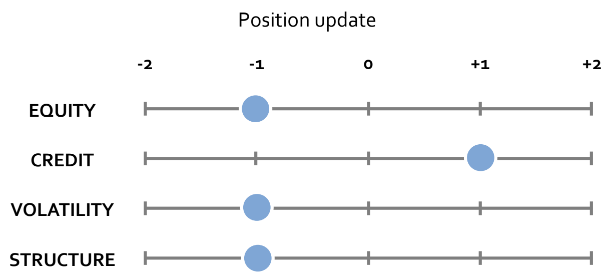


Source: Tyrus Capital, as of 30 June 2021

Bond held: Zynga 0.25% 2024 and 0% 2026

Zynga is a leading operator in the mobile games space, a global market with growth outpacing PC and console. The company operates a broad and diverse portfolio, including eight "forever franchises," which it maintains through a series of new features and content updates. Execution has been strong, and the company has a solid pipeline of titles ahead. Zynga's acquisitions of Peak and Rollic Games have considerably grown the company's respective scale in bookings and MAUs and better position it to realise longer term opportunities as it relates to network cross promotion, advertising, and platform extensions.

Another name we have known for a long time, Zynga's credit profile has improved over time, largely thanks to its scale, but more recently its free cash flow generation and net debt-neutral profile. The company has limited ESG risks, which is clearly reflected in its Sustainalytics ESG score, where it is among the top 10% of scores within Sustainalityics' total universe of just over 14,000 scores.



Source: Tyrus Capital, as of 30 June 2021

INVESTMENT THEMES: ASIAN CENTURY

- **Our "Asian Century" theme is focused on investing in Asia for the long-term as the region returns to its historical place of dominance as the largest economic zone in the world.**
- **What has happened?** Asia fundamentals remain robust, but Asian markets lag US and Europe due to concerns that we think are predominantly driven by transitory factors (i.e., Chinese regulation, higher input costs, etc.).
- **Our view:** Asian equity markets underperformed as trade flows favoured rebound candidates in Europe/US, regulation spooked investors, and higher input costs pressure margins. This results in Asian markets looking relatively even more attractively priced in our view, reinforcing our long-term Asia call – it is just a matter of time!
- **How are we positioned?** We have significant exposure to Asia and focus on long-term trends understanding that potential short-term regional pressures can overwhelm market momentum (to be expected as emerging markets evolve). Our focus on high quality and convex names helps us to navigate these headwinds. We will look to boost secondary positions on pullbacks (where drivers are temporary) while actively seeking diversification from attractive new issuance.

What has happened?

Asia fundamentals remain robust

Source: OECD, as of 31 May 2021

China continued to deliver strong macro figures in H1 2021, something that had a positive effect on the ASEAN block and the rest of the continent, but less so on the Indian economy which was negatively impacted by the COVID-19 Delta variant. It is hardly a surprise then that China is now forecasted to grow >8.5% this year. Like India, Japan was negatively impacted by the pandemic and introduced some severe lockdown measures to limit the impact by the virus on the island. However, despite the region overall reporting solid fundamental results (e.g., OECD upgraded China's growth forecasts to +8.5% in 2021, while China Manufacturing PMI data yet again came in at >50), it surprisingly lagged the US and Europe in terms of equity market performance in H1 2021. We put this down to three transitory factors: fund flows, regulation, and higher input costs.

Our view

Fund flows favour rebound candidates in Europe/US over Asia

ETF Regional Fund Flows

ETF Flow ($Mln)	Last 3Y	H1 2021	Last 6m/3y
Europe	20,281	13,220	65%
Japan	129,387	8,997	7%
Asia-ex Japan	13,469	2,030	15%

Source: Bloomberg, as of 30 June 2021

As highlighted in our Q4 2020 Strategy Report, we feel that we are at the start of a long-term global rebalancing towards Asia and China. Despite using previous quarters to accumulate exposure (cheaply), ETF flows have obviously been favouring Europe (the rebound re-allocation, which we acknowledged as being an ongoing potential flow in our Q1 report, is still strong) as can be seen in the table below (please note domestic Chinese equity flows are not included).

The main reasons behind this move in fund flows were:

- Lack of renewed enthusiasm for the region as little seems to have changed in US-China relations post Joe Biden's presidential election win (many were optimistic that President Biden would take a softer approach to China than President Trump, but that has not been the case so far)
- Rebalancing of funds away from Asia due to attractiveness of the European markets as the "value play" in 2021 after relative underperformance of Europe in 2020 and the resulting bounce-back potential of the region
- Home bias among European managers (which neither benefit from positive yields nor low volatility) as they shift from fixed income to stocks

The latter two points, in our view, are tactical and temporary given the performance of Europe YTD. However, we expect the first point to remain. We still maintain the view of our previous reports that we do not foresee any major reset of US-China relations. While President Biden's style may differ from his predecessor, the fundamental approach of the US to China remains unchanged. Eventually, we expect the market to get used to this, as it did under President Trump.

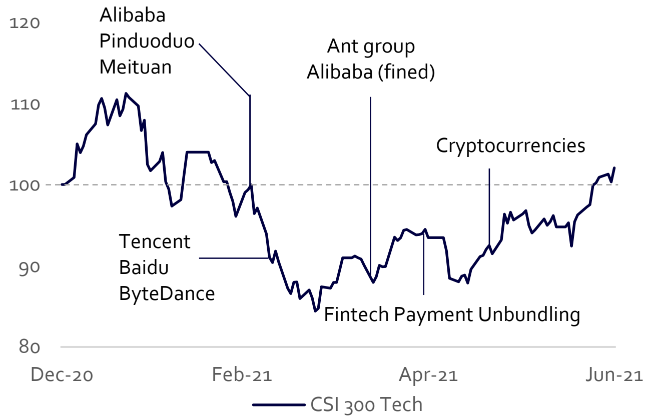
Regulation spooked investors

Consistent with our historical approach to capital allocation, we elected to deploy our assets in China across all sectors applying a strong bias for credit quality. The underlying logic has been that this not only matched our fund's objectives, but we also felt the China of today is very different from the one that emerged from 2008. While the recovery of 2008 was mostly driven by the cement- and infrastructure-related industries, President Xi Jinping's "Made in China 2025" plan looks to significantly boost the dominance of China's technology and healthcare sectors. Unfortunately, this "support" has come at a cost after the government announced it will also regulate these sectors more closely, something equity markets did not receive kindly. In our view, government intervention (e.g., improved governance and transparency) in these sectors is a positive in the long run, but the short-term uncertainty is detrimental to market performance (please see the graph below).

In 18/19, China focused on regulating healthcare, but the focus has clearly shifted to technology in 2021

In 2018/19 the regulatory focus was on healthcare, but in 2021 the focus has clearly shifted to the technology space. We see major fines being levied on China's internet giants for anti-competitive behaviour, rules to split payment services from other financial services, and a continued crackdown on the use of cryptocurrencies.

Companies / topics investigated by the Chinese technology regulator



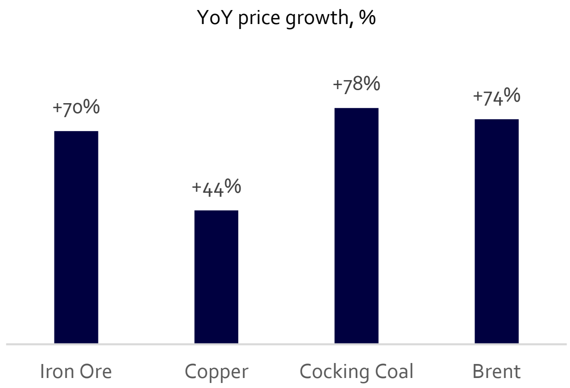
Source: Bloomberg, as of 30 June 2021

Looking at past precedent, government regulation usually results in both a negative short-term impact and increased volatility for equities. However, once clarity is achieved and relative uncertainty removed from the equation, stocks then generally tend to rebound on a timeline between three and six months (as per the case in the chart above). The advantage for us as convertible bond investors is that this type of temporary volatility is captured by the asset class given its inherent link to volatility.

While we are not privy to the inside workings of Chinese authorities and their views on whether more regulation will affect the technology space in H2 2021, we think that their motivations are very specific (potentially as President Xi learns from President Trump's social media downfall) and short term because they ultimately want to promote this sector going forward. Due to the recent credit-related events in real estate (e.g., Evergrande and Huarong Asset Management), the latest regulatory focus has been on credit regulation and the need for an overhaul of the rating system (a much-needed correction when one considers the domestic agencies' propensity to use the AAA level).

We hope that most of the significant regulatory action in key sectors is now behind us, albeit the market's reaction tends to be delayed based on precedent. That being said, there will still undoubtedly be some headlines to come as authorities now appear to shift their focus to financials.

Higher input costs pressure manufacturing margins



Source: Bloomberg, as of 30 June 2021

The (transitory) rise in commodity prices in H1 2021 has led to a surge in input costs for factories in China. While the above chart has a huge base effect and is affected by pre-existing inventory, it nonetheless demonstrates the pressure on the supply chain. A fraction of the price increase has been passed on to the consumer (Chinese factory gate inflation reached 9% in May before tumbling in June), which means the pressure on margins was great in H1 2021. However, we do think that the worst of the pressure is behind us as we can see input costs have receded and previous bottlenecks have cleared out. Ironically, as it turns out, the best cure to high prices is in fact high prices.

Asian markets now appear even more attractively priced, reinforcing our Asia call

Putting aside the long-term strategic arguments that favour investing in Asia, we think H2 2021 offers an excellent tactical positioning opportunity as we believe that: (a) the two events mentioned earlier that have been responsible for the region's market underperformance are transitory and should subside; and (b) Asian markets are now even more attractively priced.

We think Asia stacks up well in the context of high valuations in developed markets, a scenario where the big headlines are behind us in this (most unusual) economic cycle, and an assumption that each region eventually returns to its baseline growth. Global markets in other regions are up well into double-digit territory and we see little shelter from the storm building in the fixed income market. Meanwhile, Asian equities have roughly one quarter of their listed companies trading 1 standard deviation below the 5-year valuation. This compares to 12% in EMEA and 6% for the US.

Asia vs. Europe vs. US market performance

Index	YTD Return	LTM Dividend Yield	Q1 Fwd P/E Ratio	Q2 Fwd P/E Ratio
MSCI Asia Pacific Index	+5.1%	1.6%	18.3x	16.4x
MSCI Europe Index	+15.8%	2.6%	17.5x	16.9x
S&P 500 Index	+15.2%	1.3%	22.9x	22.7x

Source: Bloomberg, as of 30 June 2021

How are we positioned?

What did we do this quarter?

We increased our exposure to Asia, primarily using new issuances and well-discounted convertibles in the secondary market. From a country perspective we continued to focus on Japan, China as well as the Asian Tigers (Taiwan, Singapore, Hong Kong, and Korea) and avoided more emerging market territories who have less ability to control the pandemic and are more sensitive to commodity prices. Asia is now the cheapest region in our portfolio across almost all metrics: implied volatility, implied spread, and yield to quality relative to potential upside.

What will we do next quarter?

We would look to potentially add more to our significant Asian exposure (c.41% of our portfolio) if compelling new issuance comes to market. One element we will keep in mind is the risk of oversupply in Q4 2021 / Q1 2022, especially if the Delta variant (or other mutation) catches the region off guard and causes more lockdowns, potentially hurting the Asian economies in Q3/Q4 2021. This could be an issue for semiconductors that are sensitive to capacity, and we will monitor this closely.

Our main outlook bias

	Overweight	Underweight
Country	China, Japan	India, Philippines
Sector	Healthcare, communication services	Consumer staples, oil & gas, real estate
Trading Style	Value, growth	

Source: Tyrus Capital

What if we are wrong?

Downside risk: Despite fund flows having taken centre stage recently, we think that we are reaching the end of this (in our view, slightly overdone) rebalance. We therefore see the biggest risk to our Asian positioning as being geopolitical (e.g., China-Taiwan escalation) or due to a natural disaster (e.g., earthquake/tsunami). Given the track record of the region in past pandemics, the likelihood of a relapse in "emerged Asia" is low, especially when one considers that Asian vaccination programmes are now underway and picking up speed. The jury is still out on whether China's "zero COVID" policy will prove bulletproof in the context of increasingly aggressive variant(s), but they have proved resilience thus far. In the event of a global growth slowdown, we expect Asian domestic growth to shield us from part of the impact as it did in 2020.

Upside risk: Although historically hard manufacturing sectors (e.g., cement and steel) would lead an upswing, now, due to the focus of Made in China 2025, it will be technology and healthcare that will benefit the most, sectors we are naturally exposed to. We therefore do not feel the need to chase the rally and take unnecessary risks by embracing an overly cyclical tilt.

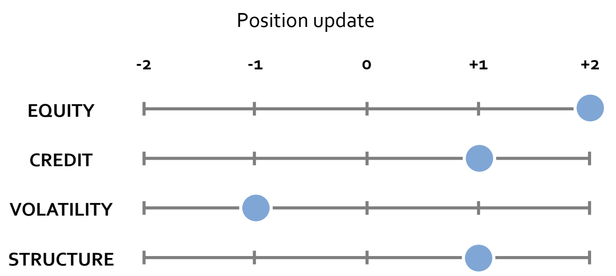
Exposure in this theme:

中國生物製藥有限公司
SINO BIOPHARMACEUTICAL LIMITED

Bond held: Sino Biopharmaceutical 0% 2025

Incorporated in 2000, **Sino Biopharmaceutical** manufactures medicines that combat cardio-cerebral diseases and hepatitis. Sino markets its products throughout China in the form of volume injections, PVC-free soft bags for intravenous injections, capsules, tablets, powdered medicines, and granulated medicines. The company also researches and develops new medicines in the realms of oncology, analgesic, and respiratory treatment.

Sino's 2025 bond has a more defensive convertible profile with a long maturity, which we feel will benefit from the planned impulse in pharmaceuticals and biotech (Made in China 2025). The company sits on a long-cash balance sheet and has a stable and growing positive FCF profile, helping to give it implied IG-quality credit (based on our internal ratings as the issuer is not rated). Sino also passed our ESG thresholds with a solid score and is a member of the MSCI Asia Pacific ESG Leaders Index.



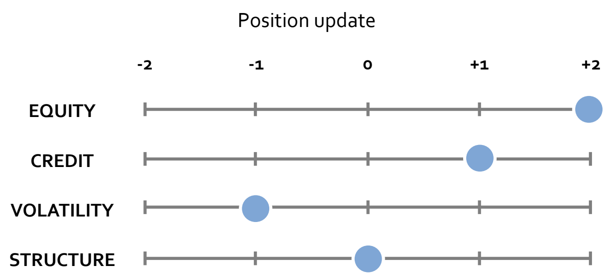
Source: Tyrus Capital, as of 30 June 2021

浙江滬杭甬高速公路股份有限公司
ZHEJIANG EXPRESSWAY CO., LTD.

Bond held: Zhejiang Expressway Co. 0% 2026

Founded in 1997, **Zhejiang Expressway** is an infrastructure company principally engaged in investing in, developing, and operating high-grade toll roads in China's Zhejiang province. They have >3,600 km in operation with exclusive rights to operate the key Shanghai-Hangzhou-Ningbo and Shangsan expressways for 30 years. Its portfolio of operations also includes subsidiaries engaged in related businesses such as automobile servicing, gas stations, and roadside billboards. The company is majority owned (>80%) by the Zhejiang Communications Investment Group.

Despite the sector in which it operates, this serial convertible bond issuer exceeded our ESG threshold, which was further helped by the company's long-term objective to promote high-quality and sustainable development. Since initiating this plan in 2019, Zhejiang Expressway gained membership to both the MSCI Asia Pacific ESG Leaders Index and the FTSE Asia ex Japan ESG Index. By having exposure in previous bonds, this is an issuer we know well and whose credit profile fit within our parameters (e.g., steady revenues and profitability).



Source: Tyrus Capital, as of 30 June 2021

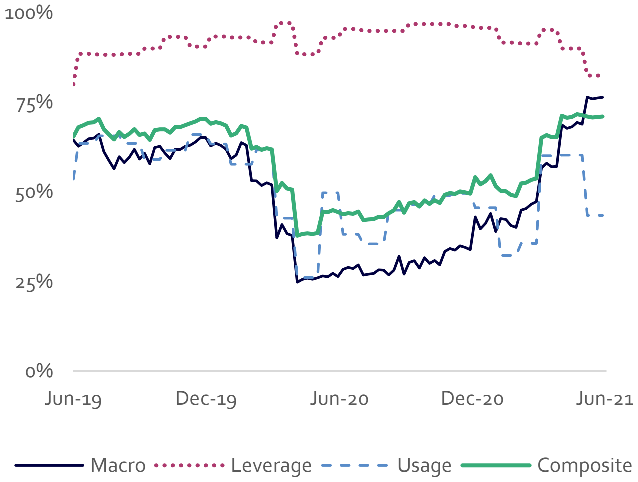
INVESTMENT THEMES: CAUTIOUS ON EUROPE

- **Our "Cautious on Europe" theme focuses on our reservations as the region has been further weakened by the pandemic.**
- **What has happened?** Europe's economic recovery has been better than expected, which has attracted more fund flows and helped to push equity markets up even further.
- **Our view:** We remain cautious as macro indicators misrepresent unemployment and reflect over-optimism. With the pandemic still by no means over, European service-heavy industries will take longer to recover. While we value some cyclical/value winners on a name-by-name basis, overall we foresee headwinds especially given uneven recovery from pandemic and service-heavy economies. Growth will stage a relative comeback overall but is underrepresented in Europe.
- **How are we positioned?** We remain cautious on valuations and variant-associated risks. We still favour large-cap, international plays and will keep an eye on spreads and inflation dynamics. It is largely difficult to benefit from growth given growth positions are generally underrepresented in Europe and our convertible universe is poorly represented in those cyclical stocks that have led European equity indices higher this year.

What has happened?

Economic recovery has been better than expected...

Tyrus Eurozone economic model



Source: Tyrus Capital, Bloomberg as of 30 June 2021

Q2 2021 was a very good quarter for Europe (better than we expected) as the region gained traction on its vaccine programme and was able to start to shift its focus more towards recovery. Although GDP prints have been anaemic since 2020, this will undoubtedly reverse out when the Euro-area YoY Q2 headline is published at the end of July. Optimism has however already showed up in macro indicators, which look surprisingly bullish, as can be seen from our economic model above, with the overall composite rising to 77% from 54% at the end of Q1 2021. The composite is now in line with pre-pandemic levels.

... which has helped push equity markets further up

We said at the end of last year that we expected Europe to be the value or tactical play for 2021. This has indeed been the case so far with the STOXX Europe 600 Index up +16% YTD as of June 2021. We also said that energy and financials would be a good place to be, but we unfortunately could not exploit these sectors within our convertible universe as financials tend to issue non-vanilla convertibles and energy scores below par from an ESG perspective.

The strength of the fund flows did surprise us, however, as well as the sharp improvement in macro data. With positive data pushing markets up further, the overreach in market has now turned into a source of more concern as valuations remain very high and still not justified by the fundamentals.

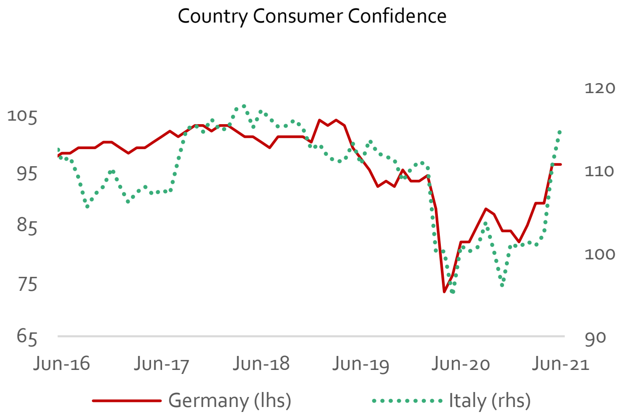
Our view

Although strong, macro indicators misrepresent unemployment and point to an overshoot in consumer confidence

A combination of an accommodative ECB that is not worried about inflation and a US high on stimulus always provides a good tailwind for macro data. However, we do not think the 77% overall composite reading on our macro model at the end of the quarter is warranted this "early" in the economic cycle. So why then does our model produce such an unexpected result? The answer lies in employment data and consumer confidence.

In terms of employment data, our humble model only compares headline unemployment numbers to historical levels. The problem with using this approach during the pandemic is the different way in which countries and regions reflect furlough in their macro data. In turn this also skews the way we analyse factors such as leverage data in our model. Unlike the US, European unemployment numbers exclude furlough. This therefore would make Europe look better on paper from an employment perspective, making a headline comparison between the two regions impossible. Unfortunately, granular data is hard to obtain, but to give an example of the potential impact of this effect, we can look at France: as of April 2021, 2.7m employees were under the reduced activity protection regime (i.e., furlough), which equates to 15% of the private sector workforce. This number has reduced from 3.2m in June 2020, but slightly higher than the 2.5m in December 2020 (the increase likely driven by the need to reintroduce lockdown measures due to France's third COVID wave). The crisis is far from over.

With regards to consumer confidence, the massive gain in confidence is likely to contain some overly optimistic outlook in our view. The strongest positive contributor to our higher macro composite print is the continued improvement in the Eurozone's Consumer Confidence Index, which has risen from -13.8 in December 2020 to -10.8 in March 2021 and to -3.3 for June 2021, a level only matched in 2017 when looking back over the last 20 years. We believe these numbers are inflated due to the very nature of escaping some of the toughest restrictive practices seen this side of the 1940's!

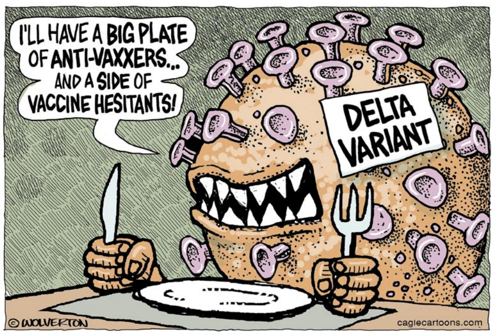


Source: Bloomberg, as of 30 June 2021

Given expectation, the pandemic can only surprise to the downside in Europe

Looking at the detail, the upside surprises are most evident among the countries in Southern Europe that have borne the stricter confinement rules, which is entirely intuitive. A closer look at the numbers show that a significant part is made up from consumers reporting an overwhelming improvement in their confidence in the future. While we would expect this feeling to naturally temper somewhat when the novelty begins to wear off, the elevated confidence levels look precarious when one takes into account the possibility of more complications in the fight against COVID.

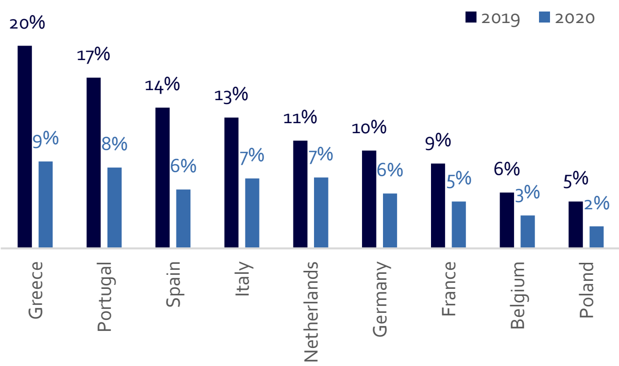
European service industries will take longer to recover



Source: Wolverton, June 2021

European service industries (on which many European countries heavily rely on) will take longer to recover from the pandemic and will continue to be impacted by it until the virus is brought under control on a global basis – a factor not currently helped by the spread of the Delta variant. This clearly impacts those economies that are most reliant on sectors such as services and tourism, such as Southern Europe. It is important to note that the easing of local restrictions in Europe will have a positive impact on the services and tourism sectors thanks to the vaccination rollouts and the success of the approved vaccines thus far (which have heavily reduced hospitalisations and mortality rates). One must remember though that the rest of the world remains constrained, and American, Chinese, or Japanese tourists are unlikely to be taking holidays en masse in the Mediterranean this summer.

Share of travel and tourism to country GDP, %



Source: Statista

Momentum is still solid

Stoxx 600 index scorecard

	Momentum	Technicals	Earning Trend	Sentiment Trend	Relative Value
Cons. Discretionary	1	6	6	1	7
Materials	2	8	1	2	6
Industrials	3	4	2	3	9
Info. Technology	5	1	3	4	11
Financials	4	11	7	5	3
Comm. Services	7	5	10	10	1
Energy	6	9	9	9	2
Health Care	11	2	5	7	10
Cons. Staples	9	3	4	8	8
Real Estate	8	7	11	6	4
Utilities	10	10	8	11	5

Source: Internal Calculations, Bloomberg, 30 June 2021

With an unattractive domestic European rate and credit market (and signs of US headline data peaking), the stronger European data means momentum continues to carry cyclical sectors ahead of the pack on the continent with leisure products, marine shipping and air freight and logistics being hot spots.

Valuations are, however, no longer what they were last year. This stresses the need to focus on considered single name selection. Given the optimism and rally to date, it is no surprise that defensive sectors (i.e., utilities, staples, and real estate) are at the bottom of the scorecard.

How are we positioned?

What did we do this quarter?

As mentioned previously, we were unable to participate fully in the European market rally given our fundamental focus and make-up of our convertible universe. Instead, we focused this quarter on special situations (such as EDF) and new issuances.

What will we do next quarter?

With the presence and potential associated risks of the Delta variant (not least the potential for pandemic policy mistakes by governments), we remain cautious and will watch how this variant and others develop, particularly in the UK and Europe (though we expect it to become more prevalent in the coming weeks as lockdown measures start to be eased further). We note there are potential political risks, the largest being pressure to taper stimulus surrounding the German parliamentary elections expected to be held on 26 September 2021 and later the French presidential election to be held on 10 April 2022.

We otherwise still favour large cap, international plays and will be diligent on sovereign spreads as they evolve over the next quarter.

Given where credit is, we still believe there will eventually be some form of a pullback as the ECB and/or local governments will decide to taper (probably post elections) at some point (something investors appear to be oblivious too). We will therefore be cautious around countries that could be vulnerable in this scenario.

Given where valuations are, we will be highly selective when it comes to pro-cyclical plays, preferring to look more at the profile of the companies that have a global advantage (e.g., luxury, renewables).

We will also closely monitor the inflation dynamics in Europe, specifically in Germany. This is not because we believe inflation will be too much of an issue (if anything, for Europe as a whole, it is part of the solution!), but because it has already reopened the debate between Northern European hawks versus Southern European doves and this would only be intensified if price indicators continue to trend higher.

What if we are wrong?

Downside risk: We see the Delta variant as a clear risk. However, because of the vaccination rollout of most European populations and the resistance of the major vaccines to the variant, we have not so far and do not expect to see going forward the same hospitalisation disaster seen in 2020. Despite the potential for government pandemic policy mistakes, we still think the impact of the variant should have a marginal impact on the strength of the recovery. For us, the issue lies more in the high valuation of European stocks (and bonds) which, like the US, should exhibit more volatility and could even potentially experience a Q4-2018-style correction.

Upside risk: Despite the survivor's bounce phenomenon being real and still having some fuel left in the tank, it is hard to justify seeing much more market upside without a fundamental step change in spending attitudes on the continent given the year-to-date performance of equity indices. Still, we see upside risk in the case of a well-coordinated and executed pan-European recovery plan. So far, the most recent mutterings coming from Germany in view of hyper-sensitivity to inflation is likely to prevent cohesion when it comes to co-ordinated efforts across the EU.

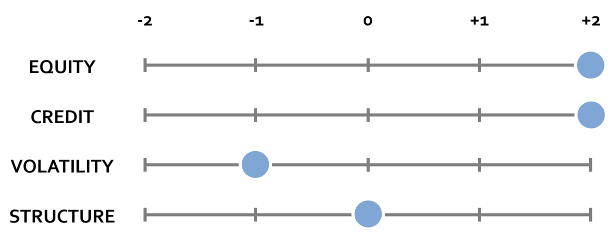
Exposure in this theme:

Bond held: EDF 0% 2024

Électricité de France S.A., commonly known as EDF, is a French multinational electric utility company largely owned by the French state. Headquartered in Paris, EDF operates a diverse portfolio of >12 GW of generation capacity in Europe, South America, North America, Asia, the Middle East, and Africa. It is also a prominent nuclear energy operator with >50 active nuclear reactors in France spread out over 19 nuclear power plants.

One of our top convictions in the portfolio and the largest European exposure in the fund, we initially invested in their green bonds at issuance and then topped up on subsequent pull backs. One factor underlying our thesis is that in the wider context of the green transformation of Europe, we are convinced authorities will have no choice but to acknowledge nuclear fission as the non-intermittent energy source with the lowest carbon footprint. As a result, EDF would be the natural regional champion. Besides this, we expect the state-supported A- rated issuer to benefit from a restructuring (which is long overdue due to drawn-out discussions between France and the EU Commission) that will unlock some further value in an already well discounted equity underlying.

Position update



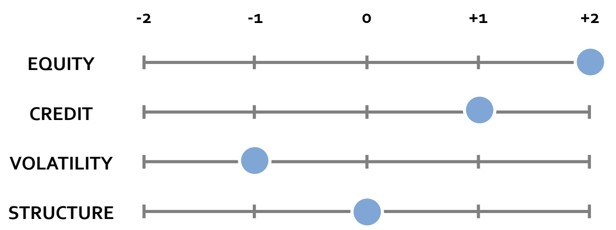
Source: Tyrus Capital, as of 30 June 2021

Bond held: Cembra Bank. 0% 2026

Cembra Money Bank AG is a Swiss bank that provides financial services including personal loans, vehicle financing, credit cards, savings, and insurance services. Cembra provides its services throughout Switzerland and employs approximately 1,000 people.

This A- S&P rated bank is one of the rare vanilla convertible bond issuers available globally in the banking sector. A low-volatility, long-term play for our portfolio, Cembra provides good diversification and excellent ESG metrics for our portfolio (it is a member of the SXI Sustainability 25 Index by the SIX Stock Exchange and sports an A ESG rating by MSCI.

Position update



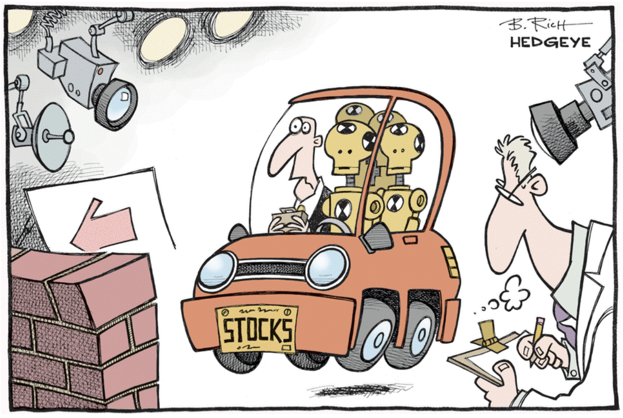
Source: Tyrus Capital, as of 30 June 2021

INVESTMENT THEMES: QUALITY BIAS

- **Our "Quality Bias" theme is built around our long-term bias towards quality issuers from a credit and ESG standpoint.**
- **What has happened?** Credit spreads tightened in both US and Europe and widened in Asia against a backdrop of fundamentals and market prices remaining disconnected.
- **Our view:** This hope-gap, combined with recent fund flows, has led to a divergence among regions. This hope and resurgence in growth stock performance in the second half of Q2 has enabled HY to outperform IG. Overall, we continue to be sceptical about long-duration bonds. Given the continued tightening in the US and Europe (unjustified by fundamentals), our conviction on quality grows even stronger, while regionally Asia offers more attractive opportunities.
- **How are we positioned?** Maintain our focus on quality names with upside potential in the stock price, investment grade credit profiles (or equivalent), and those that meet our ESG criteria. We favour larger companies who are more international, but are protected from de-globalisation trends, and those that will benefit from domestic Asian growth. We prefer searching for yields in Asia rather than looking lower down the credit spectrum in the EU and US.

What has happened?

Gap between fundamentals and market prices remains



Source: Hedgeye, 2016

From an economic perspective, and with reference to this report's title, the headline peak for growth for this current market cycle is behind us, while the positive vaccine news flow has also peaked (more so in developed markets given their vaccine rollout is well ahead of the emerging markets, which by and large have yet to hit meaningful levels).

The legitimate question for us then is whether stocks have also peaked and credit spreads bottomed out this H1 2021 given where they are now?

Looking back at the last cycle, we repeatedly voiced our unease over both equity and credit valuations, promoting convertibles as a way to hide from this pricing problem. In this regard, the current cycle started by the pandemic gave us some hope that valuations might be more reasonable, leading us to make our first calls to buy credit for quite some time in Q1 and Q2 (and partially Q3) in 2020.

Unfortunately, and faster than expected, we are now sceptical again about valuations after stimulus from central banks (and fiscal intervention) has triggered a bull run that has pushed stocks and bonds well above their pre-pandemic levels.

What concerns us even more is the fact that current valuations are higher than the previous peak at a time when the underlying economy has just experienced a brutal (albeit sharp) recession and has yet to fully recover, creating a wide divergence between fundamentals and market expectations, a gap that continues to widen.

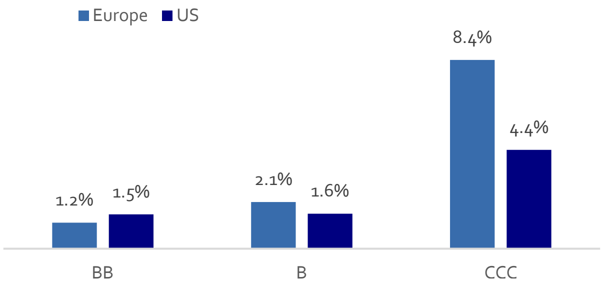
Our view

Inflation to still be transitory

As mentioned previously, we do not expect inflation to be permanently higher or rise uncontrollably, a view we still hold as base effects, commodity prices and supply chain normalisation support a transitory picture. Volatility subsided and the US 10Y treasury rate retreated toward its pre-pandemic level of 1.5% by the end of Q2 2021 (helped by large position unwinds of the losing inflation bets that had accumulated en masse alongside price inflation headlines since Q1). A similar pattern is visible on the German 10Y bunds.

Meagre returns in high yield

Yield comparison HY US and Europe (< 2 years)



Source: Bloomberg, as of 30 June 2021

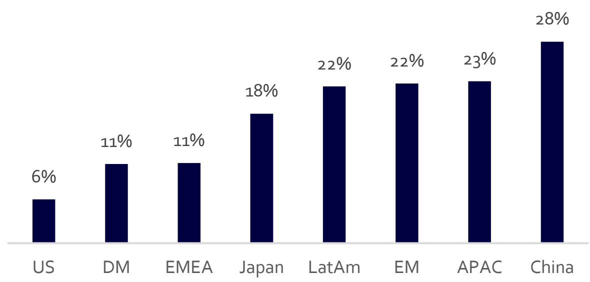
As alluded to in our previous report, we would prefer equity-sourced income rather than that from credit given how low credit returns are and the price at which they are trading. To illustrate the reality of that meagre yield, think on this: a US BB-issuer maturing in March 2023 at 100 and paying 5.25% coupon, Avient, is currently trading at 107.19. The European equivalent would be a BB+ subordinated Unicredit, redeeming in October 2022 and trading at 108.93 for a 6.95% coupon. The convergence to par in the next 12 to 18 months assuming no default is certain. To gain some potential spread compression, an investor would have to accept CCC risk – understandably difficult to swallow on a standalone basis given the risk of default when public support is removed. However, this risk is one that many are taking nonetheless on a commingled basis using one of the popular passive ETFs. In Europe the Barclays Pan-European HY index was as of 30 June sporting a B- average rating.

Equities relatively a better deal

As the saying goes: "in the country of the blind, the one-eyed man is king". Equities, especially US and European stocks, are stretched after their double-digit YTD performances. Meanwhile, emerging market and Asian equities look relatively attractive with more than 20% of the universe still trading at a significant discount to historical valuations. As a reference, in the MSCI Emerging Markets Index the average dividend paid was 1.95% as of end of June.

Overall, we are as ever still sceptical about longer-duration bonds because of their use as a cash proxy in portfolios, which means that they are sold off in difficult times (e.g., 10% drawdown in March 2020). We would therefore rather opt for precious metals, even though gold has had a bumpy ride in H1, with Q2 displaying a similar trend despite it ending up on the quarter.

% of Companies trading 1 standard deviation below 5y P/B average



Source: Bloomberg, as of 30 June 2021

How are we positioned?

What did we do this quarter?

Since late Q3 2020, we have held a very limited number of credit-driven names, and those chosen have typically been investment-grade Asian bonds. The risk-reward is simply not there. We focus overwhelmingly on volatility and equity as performance drivers: the discount for convertibles in terms of implied volatility being often larger than the yield offered in the HY space.

What will we do next quarter?

Given the status of the global economy and uncertainties around its recovery post-pandemic, we maintain our focus on quality names with upside potential in the stock price, investment-grade credit profiles (or equivalent), and those that meet our ESG criteria. We favour larger companies that are more international, yet remain protected from de-globalisation trends and also those which will benefit from domestic Asian growth.

Our main outlook bias

	Overweight	Underweight
Credit	Investment grade	High yield
Sector	ESG friendly	ESG unfriendly
Target Size	Large cap	Small cap
Diversification	Global, domestic Asia	Domestic Europe

Source: Tyrus Capital

What if we are wrong?

Downside risk: Given how tight spreads are, credit widening is a real issue. We do not see an immediate risk given the degree of stimulus underway, but we do see this becoming more of a problem in the next 6 to 18 months when tapering would need to be implemented in some form or another. Given our investment-grade bias, we should fare better from a spread-widening risk perspective. Furthermore, it is important to note that by having an investment-grade bias, we are at risk of missing out on higher-growth, HY equity stories, as was the case on some names in 2020 (e.g., Tesla). However, this is a position we are happy to take given the risk-reward balance of owning HY names, with liquidity risk being a good example of distinct HY risk. Recall for example that HY convertible volumes in March 2020 were virtually non-existent.

Upside risk: Credit spreads are at 10-year lows. They might push a bit further, but realistically we do not see upside risk due to spreads. There are equity stories we have missed out on due to our quality restrictions, but those names are not "credit" plays and should be invested directly through stocks if efficiency and liquidity are key principles.

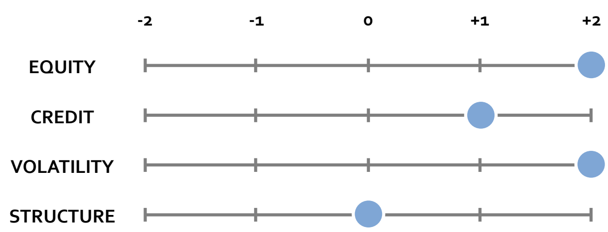
Exposure in this theme:

Bond held: GSK/Theravance 0% 2023

Headquartered in the UK, **GlaxoSmithKline** ("GSK") is a leading research-based pharmaceutical company. The company develops, manufactures, and markets vaccines, prescription and over-the-counter medicines, and health-related consumer products. GSK provides products for infections, depression, skin conditions, asthma, heart and circulatory disease, and cancer.

One of the few vanilla exchangeable convertible bonds in our portfolio, this bond benefits from the rock-solid credit of its S&P A-rated pharma issuer (GSK) while granting access to the potential equity upside of biotech firm Theravance, a 53% realised volatility stock we could never access on a standalone basis due to its low credit quality.

Position update



Source: Tyrus Capital, as of 30 June 2021

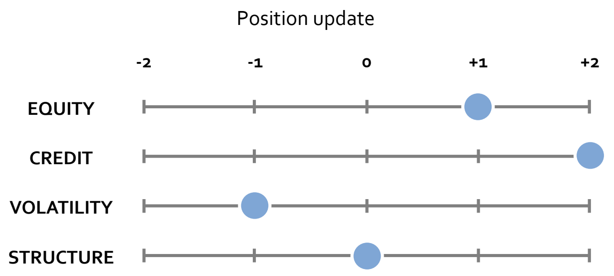
PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Anthem

Bond held: Anthem 2.75% 2042 (call 2022)

Anthem operates as a health benefits company and is one of the largest US health insurers with >40 million members in the country. The company provides health, dental, vision, and pharmacy benefits as well as life and disability insurance benefits. Anthem also offers a broad spectrum of network-based managed care plans to employers, individuals and Medicaid and Medicare markets.

Despite benefiting on the credit side from this S&P A-rated issuer, Anthem is also our highest internally rated ESG name. The company has put in place a tight timeline to improve its carbon footprint and targets a 46% reduction in its greenhouse gas emissions by 2023, with a target of going 100% renewable in all its offices by 2025. It is also a member of the FTSE4Good Index and the Dow Jones Sustainability Index.



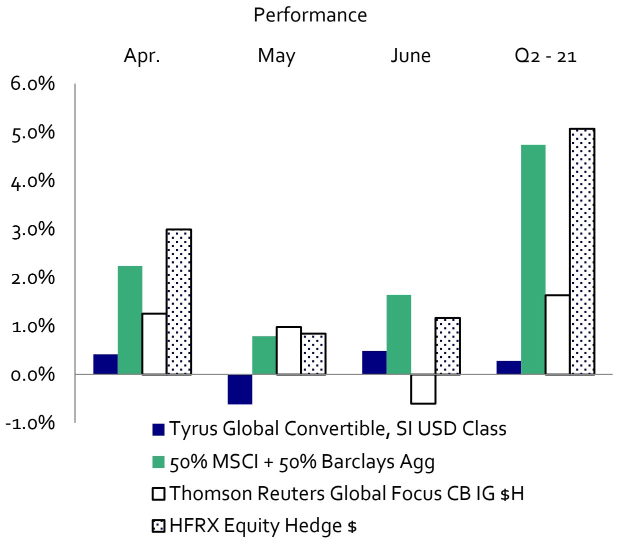
Source: Tyrus Capital, as of 30 June 2021

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

PERFORMANCE REVIEW

Overview

Our **Tyrus Capital Global Convertible Strategy delivered +0.3%** (SI USD Hedged), underperforming both the Refinitiv Global Focus IG Index (USD Hedged) and the popular UCITS Equity Alternative benchmark. This is a result of our strict focus on quality, discounted bonds, and ESG-compliant companies, all of which mean we missed some of the more exuberant shorter-term performers. We were also impacted by our overweight position on Asia and underweight on Europe as Asian equities underperformed while Europe outperformed.



	Apr.	May	June	Q2 - 21
Tyrus Global Convertible, SI USD Class	0.4%	-0.6%	0.5%	0.3%
MSCI AC World TR Loc CCY	3.7%	1.1%	2.1%	7.1%
Barclays Global Agg Corporate $ TR	0.8%	0.5%	1.1%	2.4%
50% MSCI + 50% Barclays Agg	2.2%	0.8%	1.6%	4.7%
Thomson Reuters Global Focus CB IG $H	1.3%	1.0%	-0.6%	1.6%
HFRX Equity Hedge $	3.0%	0.8%	1.2%	5.1%

Source: Bloomberg, Tyrus Capital, as of 30 June 2021

The public track record of the TYNCBSH LX Equity performance is used (i.e., the SI USD Hedged share class). Past performance is not a guarantee of future performance.

Detailed Q2 analysis

Region split	Avg. Weight	Avg. Perf	Net Cont.	Impact
Americas	32.7%	0.7%	0.2%	86%
Emea	21.7%	0.8%	0.2%	64%
Asia	40.0%	-0.9%	-0.4%	-129%
Other	5.6%	-	0.2%	-

Sector split	Avg. Weight	Avg. Perf	Net Cont.	Impact
Consumer Dis.	10.4%	3.0%	0.3%	111%
Materials	4.5%	5.1%	0.2%	81%
Info.Technology	19.4%	0.7%	0.1%	49%
Energy	1.7%	4.4%	0.1%	27%
Healthcare	16.1%	0.2%	0.0%	10%
Utilities	4.3%	0.2%	0.0%	3%
Consumer Staples	1.9%	-5.6%	-0.1%	-37%
Financials	11.6%	-1.3%	-0.1%	-
Industrials	8.5%	-2.5%	-0.2%	-76%
Com. Services	16.0%	-1.6%	-0.3%	-93%
Other	5.6%		0.2%	78%

Delta split	Avg. Weight	Avg. Perf	Net Cont.	Impact
High	9.2%	4.4%	0.6%	199%
Medium / High	27.3%	2.6%	0.8%	298%
Medium	31.8%	-1.3%	-0.5%	-171%
Medium / Low	22.6%	-3.3%	-0.9%	-315%
Low	3.4%	0.5%	0.0%	4%
Other	5.6%	-	0.2%	-

Source: Bloomberg, Tyrus Capital, as of 30 June 2021, all figures net of fees (SI USD Hedged Share Class). Past performance is not a guarantee of future performance.

Avg. Weight: Average weighted based on NAV. **Avg. Perf.:** Absolute average performance for the considered segment in local currency terms. **Net Cont.:** Net contribution to the quarterly performance in local currency terms. **Impact:** Relative contribution to the quarterly performance in local currency terms. Other and costs: Include cash and hedging impact, fees, transaction fees and other costs (if any).

Top / bottom performers

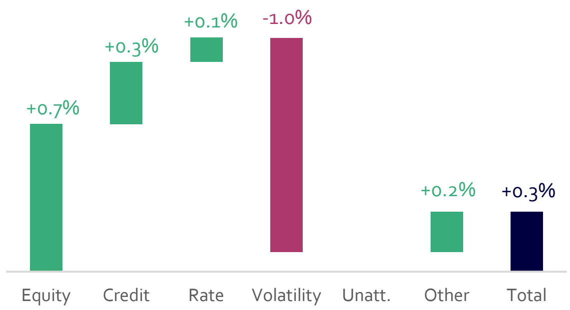
Top 5 / Worst 5	Avg. Weight	Avg. Perf.	Net Cont.
SBIOIN 0 06/29/25	1.6%	17.3%	0.2%
MEITUA 0 04/27/28	1.3%	9.6%	0.2%
ETSY 0 ⅛ 10/01/26	0.4%	22.6%	0.2%
ZHOSHK 0 05/21/25	1.9%	8.2%	0.2%
PFPT 0 ¼ 08/15/24	0.4%	13.9%	0.2%
ZHEDIN 0 06/30/25	1.0%	-5.6%	-0.1%
MAILLI 1 ⅝ 10/01/25	1.7%	-3.9%	-0.2%
GSK 0 06/22/23	2.4%	-6.1%	-0.2%
LITE 0 ½ 12/15/26	1.3%	-10.1%	-0.2%
YY 1 ⅜ 06/15/26	1.7%	-17.2%	-0.3%

Source: Bloomberg, Tyrus Capital, as of 30 June 2021

Avg. Weight: Average weighted based on NAV. **Avg. Perf.:** Absolute average performance for the considered segment in local currency terms. **Net Cont.:** Net contribution to the quarterly performance in local currency terms.

Performance drivers

Net performance contribution for the quarter (bottom up):



Source: Bloomberg, Tyrus Capital, as of 30 June 2021

As we can see on the previous page, convertibles underperformed equities (+1.6% vs. +7.1% for equities) and we underperformed the convertibles benchmark (+0.3% vs. +1.6% for the benchmark).

Convertibles underperformed equities due to: (i) sector and index bias, and (ii) an adverse equity volatility headwind.

As we can see on the chart above, we only achieved a +0.7% underlying equity performance in Q2. Given our fixed delta of 50%, our equity performance implies an average underlying equity market price move of +1.4%, but equities in fact retuned +7.1% (MSCI ACWI World Index, USD Hedged). This deviation is because we are not able to be exposed to those sectors that outperformed due to our credit and ESG requirements (as mentioned in previous reports), and therefore this is not a matter of single name selection. These sectors include energy and financials, which helped drive the global market rally: the energy sector returned +9.0% in Q2 and +33.2% YTD (MSCI World Energy Index) while financials returned +6.8% in Q2 and +21.2% YTD (MSCI World Financials Index). It is worth noting that those large outperforming companies in the Stoxx Europe indices aren't very well represented in the convertible universe, hence why equities might rise while convertibles do not.

The second point is a little less obvious. Convertibles have suffered a re-racking down of general market volatility. Looking at the 90-day VIX Index moving average: we moved from 22.9 to 19.3 this quarter (from 26 at the start of the year). With a Vega sensitivity of about 0.5, this would translate into an average 1.8 points underperformance. In other words, regardless of the convertible dynamics, the asset class is impacted by volatility coming down across the board. In the case of our fund, as evidenced by the red column on the chart on the left, the shock is about 1 percentage point on overall performance. This impact is a tailwind for the asset class when stress surges like last year but a headwind in more complacent environments. The irony in this being that, solely from a performance standpoint, convex profiles being more volatility-sensitive have been penalised more than distressed-profiles or equity-like profile. This optical difference is immediately removed when considering the risk-adjusted return.

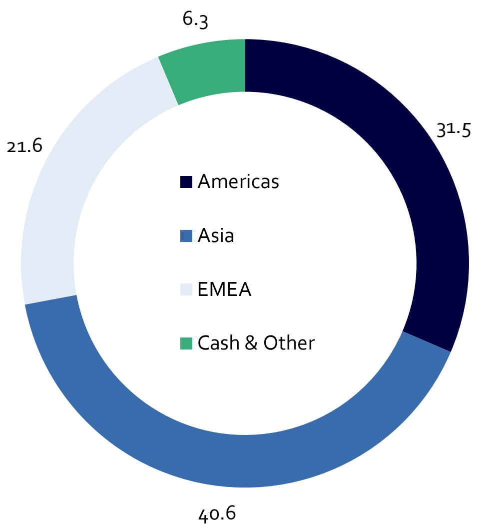
Meanwhile, our underperformance to the convertible benchmark is primarily due to the regional construction of our portfolio and that of the benchmark. The convertible benchmark is made up of c.50% European exposure, while Europe is our smallest exposure (22%) and Asia our largest (41%). So far this year, Asia has unfortunately lagged Europe in terms of performance: Europe has returned +6.7% in Q2 and +15.8% YTD (MSCI Europe Index), while Asia returned +2.6% in Q2 and +5.1% YTD (MSCI AC Asia Pacific Index). As mentioned above, our credit and ESG bias limited our ability to venture into the more pro-cyclical European names that outperformed as we expected in H1. This did, however, enable us to take advantage of Asia's lower valuations to consolidate our holdings in the region.

PORTFOLIO ANALYSIS

Overview

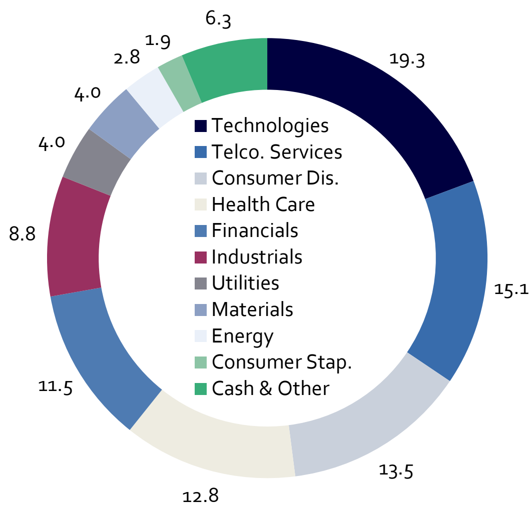
All exposures are as of 30 June 2021.

Exposure by region



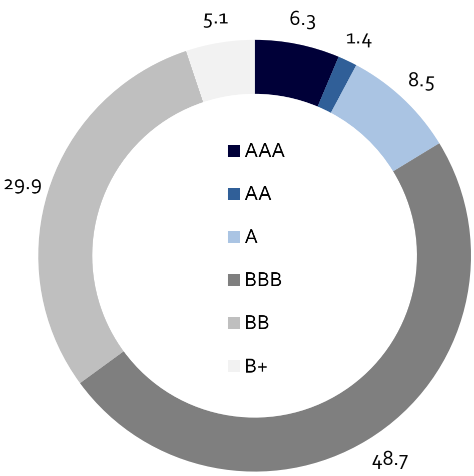
Note: EUR exposure in % of total portfolio

Exposure by sector



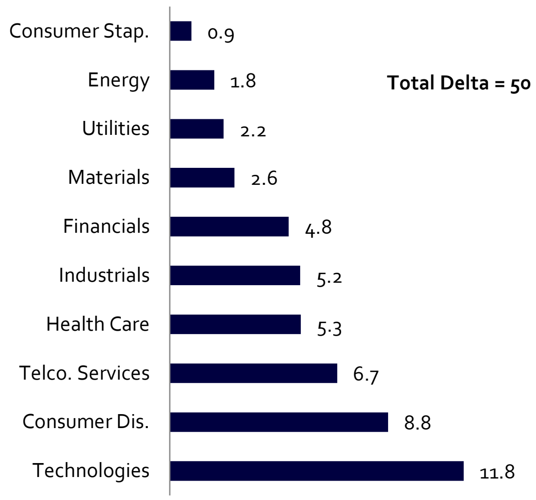
Note: EUR exposure in % of total portfolio

Exposure by credit rating



Note: EUR exposure in % of total portfolio. Includes internal ratings where external ratings are not available

Attribution of delta by sector



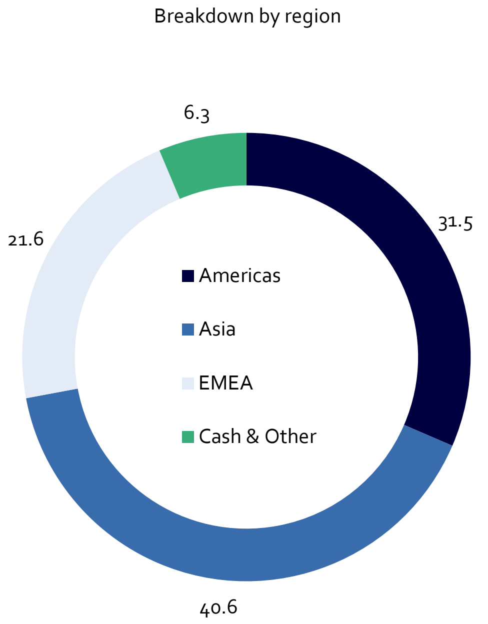
Note: In delta points, a +10% increase in technology stocks will result in a +1.3% increase in the fund before the effect of convexity. Sum of sector's delta = total fund exposure

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Detailed Analysis

All splits, breakdowns, and analysis are as of 30 June 2021. As of 30 June 2021, the portfolio is comprised of 87 convertible positions with a further 6.3% in cash and other cash equivalents.

Exposure by region: total portfolio



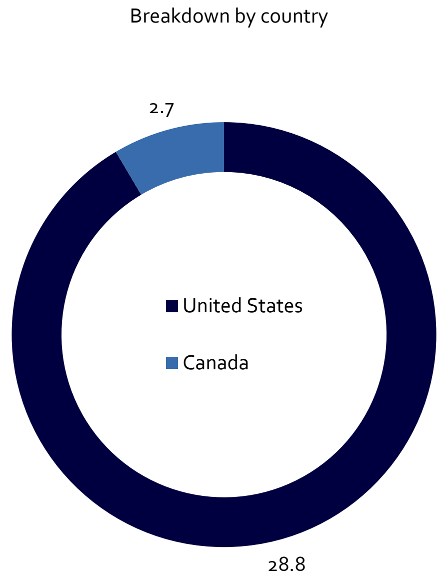
Note: EUR exposure in % of total portfolio

Asia continues to be our biggest region followed by the US. The US weight dropped slightly due to US equities becoming more expensive and limited options when it came to finding discounted convertibles and undervalued (or at least fairly-valued) equity underlyings.

Key Changes:

- Americas -3.3%
- Asia +1.8%
- EMEA -0.5%
- Cash & Other +2.1%

Exposure by region: Americas



Total Americas Exposure = 31.5

Note: EUR exposure in % of total portfolio

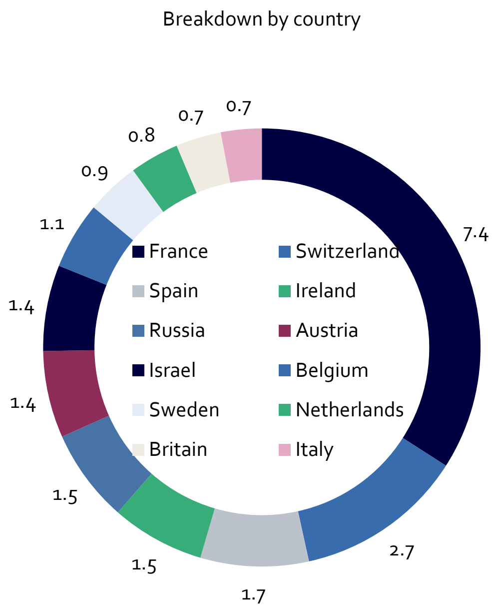
Rotation within the US was mostly driven by our convexity extraction, whereby we reduced equity outperformers in a typical contrarian fashion whenever their convexity went lower. New issuances (plentiful) were used to replenish our holdings when valuations were acceptable.

Key Changes:

- **United States: -3.5%**
  - \+ Palo Alto Networks
  - \+ Pioneer Natural Resources
  - \+ Winnebago Industries
  - \- Lumentum Holdings
  - \- Envestnet Inc
  - \- Teladoc Health Inc
- **Canada: +0.2%**
  - \- SSR Mining

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Exposure by region: EMEA



Total EMEA Exposure = 21.6

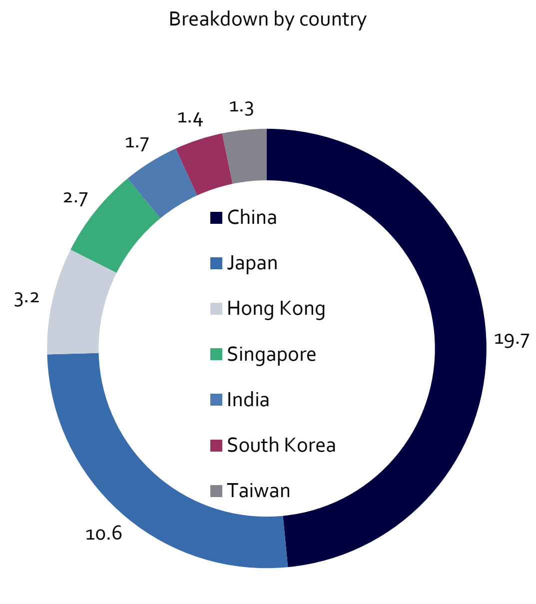
Note: EUR exposure in % of total portfolio

Europe is still our smallest allocation. Once again, there were a lack of opportunities to play the European value rebound within the scope of our investment mandate.

Key Changes:

- **France: +2.1%**
  - + Edenred
  - + Engie SA
- **Russia: -2.0%**
  - - Mail.Ru Group
- **Sweden: -0.7%**
  - - Spotify Technology S.A.

Exposure by region: Asia



Total Asian Exposure = 40.6

Note: EUR exposure in % of total portfolio

We used both the correction and new issuances to increase our Japanese exposure. Reductions were here again typically a result of equity outperformance.

Key Changes:

- **Japan: +1.8%**
  - + GMO Payment Gateway.
  - + Mercari Inc.
  - - Terumo Corporation
- **Hong Kong: +0.7%**
  - + Far East Horizon Ltd
- **Australia: -1.23%**
  - - Afterpay Limited
  - - Washington H. Soul Pattinson & Co. Ltd.
- **Taiwan: -1%**
  - + Globalwafers Co.
  - - Zhen Ding Technology Holding Limited
  - - Asia Cement Corporation

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Overall risk exposure

Key Greeks:

Delta	49.97%
Gamma	0.61
Vega	0.51
Modified Duration	2.24 yrs

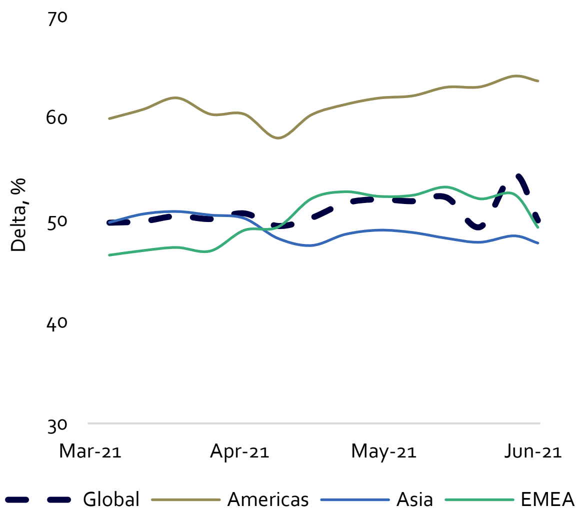
Source: Tyrus Capital, as of 30 June 2021

Definitions:

- **Delta:** delta is a measure of how sensitive a convertible bond's price is to changes in the price of its underlying stock. The higher the delta, the closer it trades to its underlying stock price. A delta of 100% means a 1-to-1 transfer of the equity movement to the instrument.
- **Gamma:** measures the rate of change of the delta itself. A bond with a higher gamma should see its own delta rise quickly. Gamma can also serve as a proxy for convexity (the ratio of upside versus downside for a convertible bond if the underlying stock price was to move up and down by a similar percentage).
- **Vega:** the change in an option or convertible price for a 1% move in volatility. Higher vega convertibles are more sensitive to changes in volatility than a lower vega convertible.
- **Modified duration (also known as Rho):** expresses the measurable change in the value of a security in response to a change in interest rates: the higher the duration, the more sensitive to rate changes it is. Higher duration bonds are more affected by changes in interest rates versus short duration bonds because higher duration bonds have longer until their maturity.

As usual, our delta oscillated around our target 50% during the quarter. It is worth mentioning is that our modified duration was very stable this quarter, only fluctuating between 2.2-year and 2.4-year range.

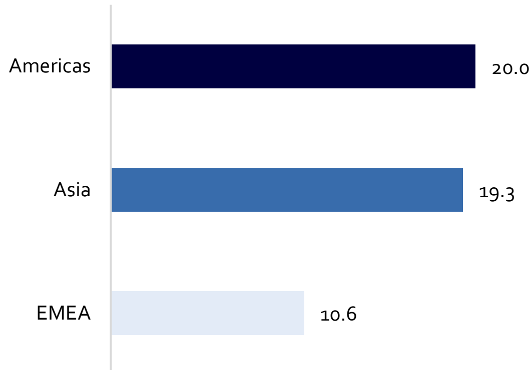
Delta average per regions, Q2 2021



Source: Tyrus Capital, as of 30 June 2021

Attribution to delta risk

Regional breakdown as of 30 June 2021



Note: In delta points, a +10% increase in an Americas stock will result in a +2.1% increase in the fund before the effect of convexity. Sum of region's delta = total fund exposure

Our overall delta only very slightly decreased from 50.3% at the end of Q1 2021 to 50% at the end of Q2 2021. Despite our rotation towards Asia, our actual delta risk exposure between Asia and the US is evenly split.

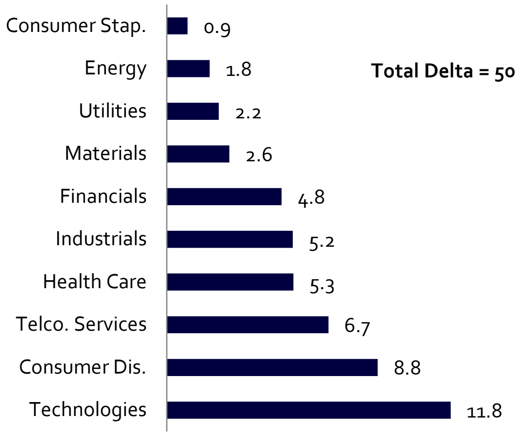
<u>Key Changes:</u>

- Americas: -0.8 pts
- Asia: +0.1 pts
- EMEA: +0.3 pts

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Sector delta risk

Sector breakdown as of 31 March 2021



Note: In delta points, a +10% increase in Technology stocks will result in a +1.18% impulse in the fund before the effect of convexity. Sum of sector's delta = total fund exposure

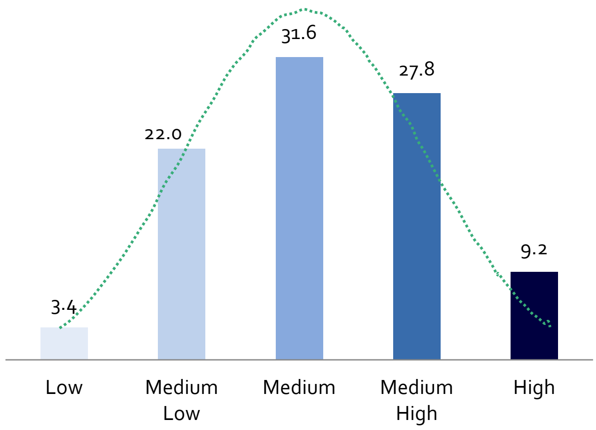
Our sector fluctuations were mostly driven by single names becoming less convex as opposed to a macro change.

Key Changes:

- Health Care: -2.5 pts
- Technologies: -1.2 pts
- Consumer Dis.: +3.7 pts

Overall delta fund profile

Portfolio delta by type, % of fund



Note: Delta range: Low is 0-20, Medium Low is 20-40, Medium is 40-60, Medium High is 60-80, and High is 80-100

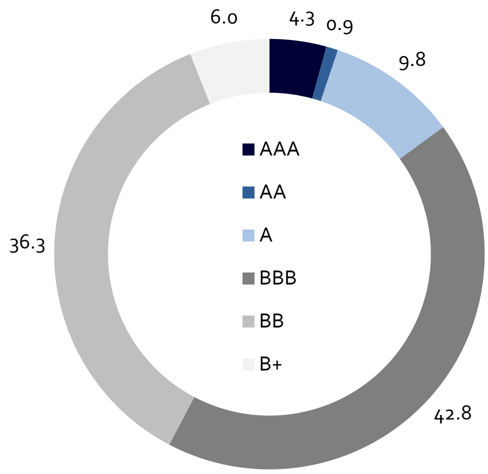
Source: Tyrus Capital, as of 30 June 2021

Our portfolio exhibited our typical Gaussian distribution of risk. Two points to highlight:

- We had a slightly higher weight in the Medium High range, albeit a good chunk of the delta in this range was within the 60% to 65% range (i.e., borderline medium range).
- Our lower exposure on lower delta names continues to be a function of limited good yielding opportunities relative to our capital usage, and not because we want to reduce modified duration (and therefore sensitivity to interest rates) in light of the yield curve movements.

Credit risk

Credit quality breakdown



Note: EUR exposure in % of total portfolio. Includes internal ratings where external ratings are not available

Excluding our cash positions, we maintained our average credit rating for the portfolio at BBB-. As explained in our last investment theme, we see no upside from available (or lack of) credit compression given valuations, so having modified duration risk on HY names is clearly not something we are seeking.

Top 10 positions as of 30 June 2021

	%
SSR Mining Inc. 2 ½ 39	2.68
Sino Biopharmaceutical 0 25	2.47
Electricite de France 0 24	2.46
Theravance Biopharma Inc 0 23	2.46
Zhejiang Expressway Co. 0 26	2.28
Zhongsheng Group 0 25	2.07
Akamai Technologies 0 ⅜ 27	2.03
Stride, Inc. 1 ⅛ 27	2.01
Meituan 0 28	1.95
Zynga Inc. 0 26	1.93
Total	22.35

Note: EUR exposure in % of total portfolio

Given the increase in our exposure to Asia and associated decrease in the Americas, our top 10 positions changed quite a bit this quarter.

Key Changes:

+ Meituan
+ Zhongsheng Group
+ Zynga Inc.
- Mail.Ru
- Lumentum Holdings Inc
- 3SBio, Inc.

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

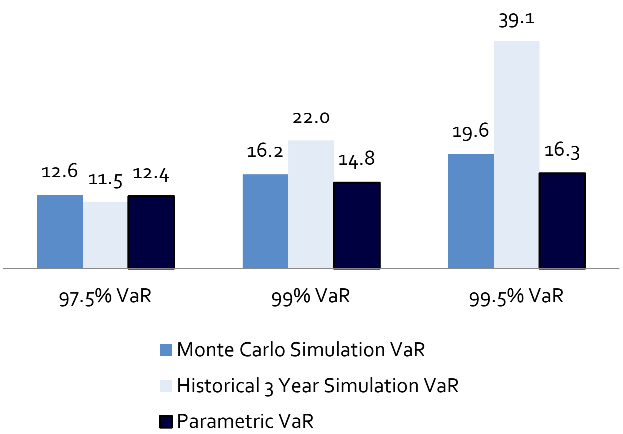
Risk Analysis

As of 30 June 2021, a more detailed report is available upon request.

Value at risk analysis

All value at risk ("VaR") calculations are based on the new Bloomberg regional risk factor model (v7) for the EUR Hedged SI share class (ISIN: LU1357022695). A historical 3Y methodology is used when no methodology is specified.

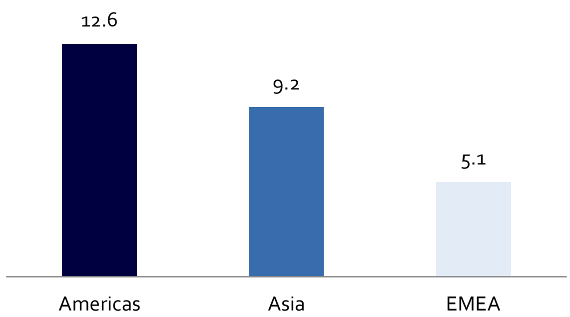
VaR by confidence level (in %)



Note: 3 years horizon (252 days, scaled 1 day). Source: Bloomberg, as of 30 June 2021, FX risk included

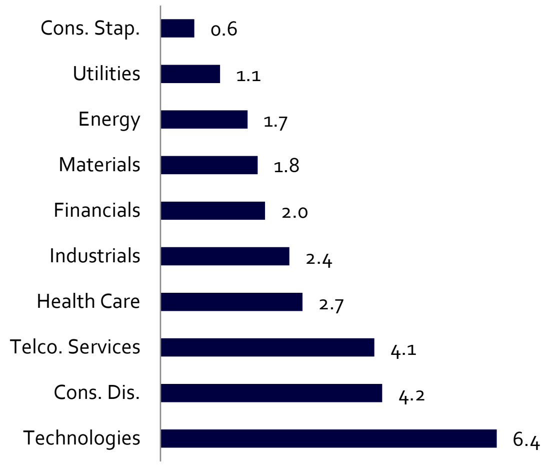
To reveal the impact of each aggregate, the following VaR analysis is done with the FX component turned off (to remove noise stemming from the currency element):

99% VaR by region (in %)



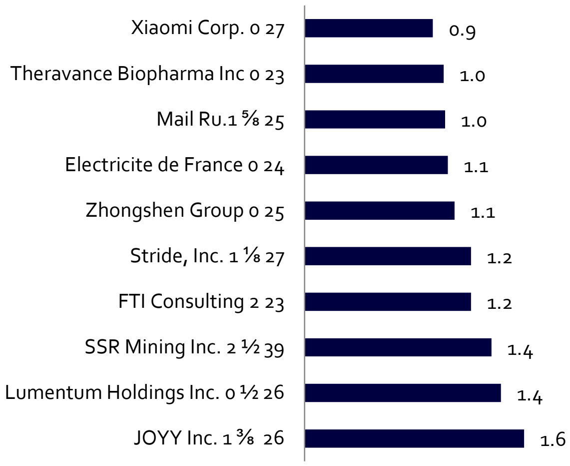
Note: 3 years horizon (252 days, scaled 1 day). Source: Bloomberg, as of 30 June 2021, FX excluded

99% VaR by sectors (in %)



Note: 3 years horizon (252 days, scaled 1 day). Source: Bloomberg, as of 30 June 2021, FX excluded

99% VaR by security (in %)



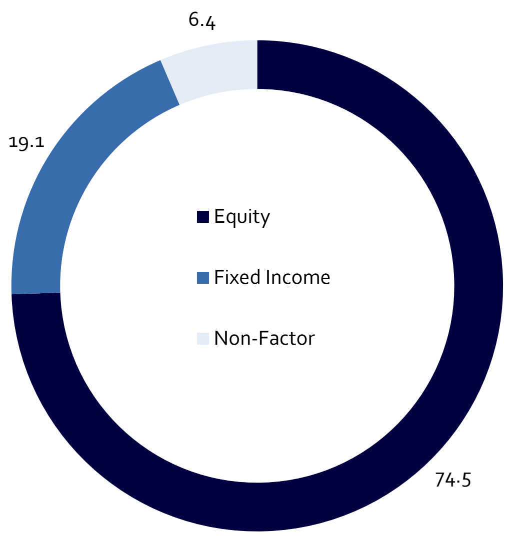
Note: 3 years horizon (252 days, scaled 1 day). Source: Bloomberg, as of 30 June 2021, FX excluded

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Risk factor analysis

As of 30 June 2021, all indicative calculations are based on the Bloomberg Factor Model (v7).

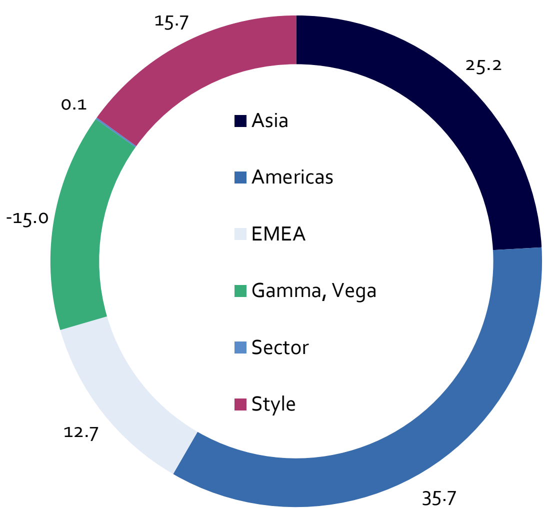
Top level factor breakdown, %



Source: Tyrus Capital, Bloomberg as of 30 June 2021, FX excluded

Please note that despite the return to more elevated spreads and fixed income volatility, our strategy remains predominantly driven by equity and equity volatility.

Equity factor breakdown, %

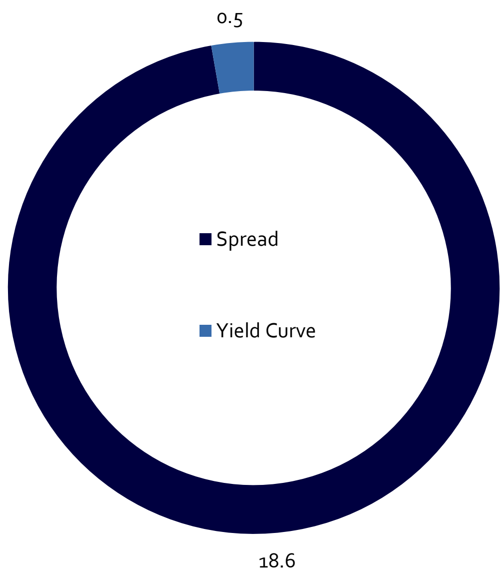


Note: Total equity factors represent 74% of the strategy's risk.

Source: Tyrus Capital, Bloomberg as of 30 June 2021

c.19% our fixed income (i.e., credit and rate-related risk) has the following impact:

Fixed income factor breakdown, %



Note: Total fixed income factors represent 19% of the risk.

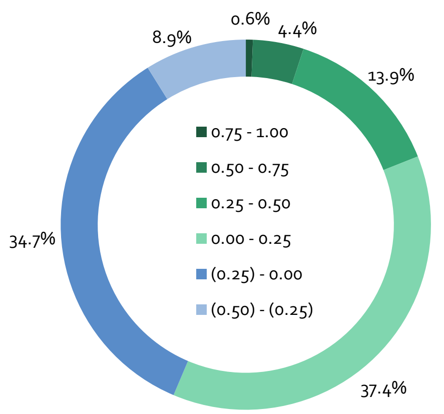
Source: Tyrus Capital, Bloomberg as of 30 June 2021

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

ESG Analysis

Analysis as of 30 June 2021, a more detailed report on our carbon footprint is available upon request. Please note we have updated our ESG reporting in line with the technical specifications of the EU Sustainable Finance Disclosure Regulation ("SFDR") regulation that came into effect in March 2021. Our internal ratings are now between +1 (Best) and -1 (Worst) and are attributed on a "Best-In-Class" basis within our universe on a sector-by-sector basis. This replaces our former "Worst", "Neutral", "Good" ESG labelling system. Our internal ESG score is the average of our E, S and G scores (note green bonds are not retreated and cash and FX are both excluded). **Our ESG internal score as of Q2 2021 is +0.02 (neutral)**.

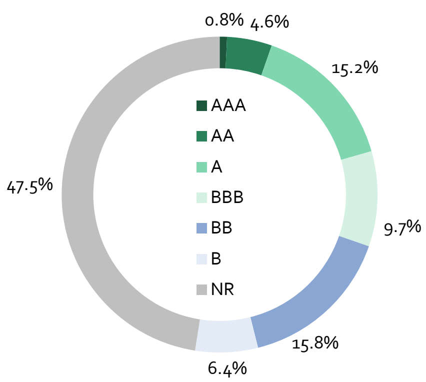
Contribution to ESG internal scoring, %



Average ESG Internal Rating 0.02

Source: Tyrus Capital as of 30 June 2021

Contribution to ESG rating from MSCI, %

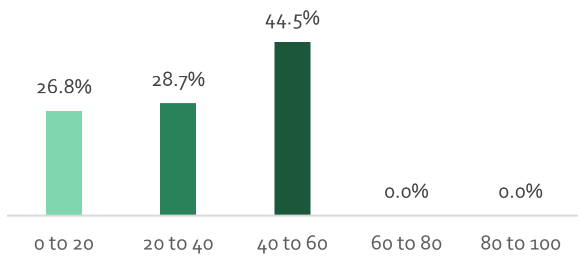


Average MSCI ESG Rating: BBB

Source: MSCI as of 30 June 2021

The quality of our ESG score relies on the availability of ESG data reported. To track the relevant information and see how our universe improves its transparency over time, we also use Bloomberg's ESG disclosure metric. Here, a score of 100% means that the company publishes data on all the ESG metrics tracked by Bloomberg, while a score of 0% means no information is provided. We then combine the information disclosed with our "Best-In-Class" analysis approach for each sector for a given year and ignore those companies where the sample group in sector is too small. This ensures companies do not artificially receive a good score due to a lack of sufficient companies reporting in their respective sector.

Contribution to Bloomberg ESG data disclosure score, %



Average BBG Rating 35.18

Source: Bloomberg, Sustainalytics, as of 30 June 2021

One last important factor to mention are green bonds, which are quite rare in our convertible universe now. Please note our ESG score now considers "Green Bond" specifically adjusting their "E" score to isolate the bond unique use of proceed versus the rest of the company. Obviously, we will continue to carefully look at green issuance actively whenever possible over their traditional counterpart when profiles are similar.

3% **Invested in Green Bonds**

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

OUR TEAM

Damien Regnier, Portfolio Manager

Damien joined Tyrus Capital from Tyndaris LLP where he headed the global convertible bonds investment business.

Prior to Tyndaris, Damien was the portfolio manager for global convertible bonds for several entities of the Deutsche Bank group in Frankfurt with USD 4.5 bn of assets. He first designed the current strategy in 2010 and has achieved a 5-star Morningstar performance rating over that period.

Previously, he was a founding member of Vega-Chi Ltd. covering European and Asian Convertibles operations and a trader at J.P. Morgan as a member of the EMEA Convertible Trading & Arbitrage team. Damien started his career as a graduate actuary at APICIL group and Pro BTP Finance in the ALM department.

Damien is an ISFA Actuary with a research thesis on "Convertible bonds: models & strategies" from the University Claude-Bernard Lyon I in France in partnership with the Institute of Actuarial Sciences and Insurance (ISFA). He also holds a MSc in Finance & Investment from Queen Mary University.

Tom Roberts, Deputy Portfolio Manager

Tom co-manages the Global Convertible Fund with Damien.

Prior to joining Tyrus Capital, Tom has spent over 15 years in the convertible and derivatives market, first spending time as a Japan convertible research analyst at HSBC before joining Mizuho's convertible bond desk. He then moved to Citigroup where he helped build a top-tier Asia-Pacific convertible and equity-linked platform. He returned to HSBC to specialize in convertible bonds and derivatives before joining Berenberg's fixed income team adding high yield bond experience to his repertoire.

Tom has also worked within the entrepreneurial side of private markets having been recently involved in the structuring and set-up of a litigation fund GRP. He is also particularly attuned to the needs of institutional investors having spent significant time within the capital raising solutions field across public and private asset classes.

Tom graduated from the University of Bristol with a degree in Economics and Accounting, BSc (Honours).

Tanguy Gourmelon, Senior Risk Analyst

Tanguy joined Tyrus Capital from Tyndaris LLP as a Senior Risk Analyst. He is also a senior member of the firm-wide Risk, Compliance & Operations team.

Prior to joining Tyndaris in 2016, Tanguy worked for 6 years in Carmignac Gestion (AUM of EUR 31 bn) as a Middle Officer in support of the Portfolio Managers Team for Equity, Mixed and Fixed Income Managements.

Prior to joining Carmignac, Tanguy worked for J.P. Morgan's Structured Fund Management team to support the Fund Administration and the Operational Fund Structuring for Funds linked to all the main asset classes, from trackers through to funds linked to J.P. Morgan algorithmic strategies and indices.

Tanguy graduated from the Institut Superieur de Gestion Paris in Business and Economics.

Shray Amar, Fundamental Global Equity & Credit Analyst

Shray joined Tyrus Capital from Tyndaris LLP and primarily focuses on fundamental analysis.

Shray has spent his career working mainly within equity and credit asset classes, with a focus on investing across both global private and public markets, as well as corporate strategy, investment banking, and M&A.

His experience includes working as an equity analyst with Silver Mount Capital, a member of the Private Equity investment teams at Partners Group and GMT Communications Partners, and the Investment Banking and M&A teams at Ondra Partners and Merrill Lynch.

Shray graduated from Imperial College London in 2010 with a degree in Chemistry and Management, BSc (Honours) & ARCS.

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