THE CASE FOR HYBRID BONDS

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Corporate Euro denominated Hybrid Bonds remain a little known asset class and are not well represented within the mutual funds business. This documents aims to provide insight on the specifics of these instruments as well as to highlight their relevance in a fixed income asset allocation. As early as 2013, Azimut was the first international asset manager to appreciate the importance of Euro Hybrid Bonds and to launch a Luxembourg UCITS fund, exclusively dedicated to the Corporate Euro Hybrids, with no exposure to banks. Here, we also discuss the key characteristics of our strategy, as it nears its fifth anniversary.

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The case for AZIMUT Hybrid Bonds Fund

I. Introduction

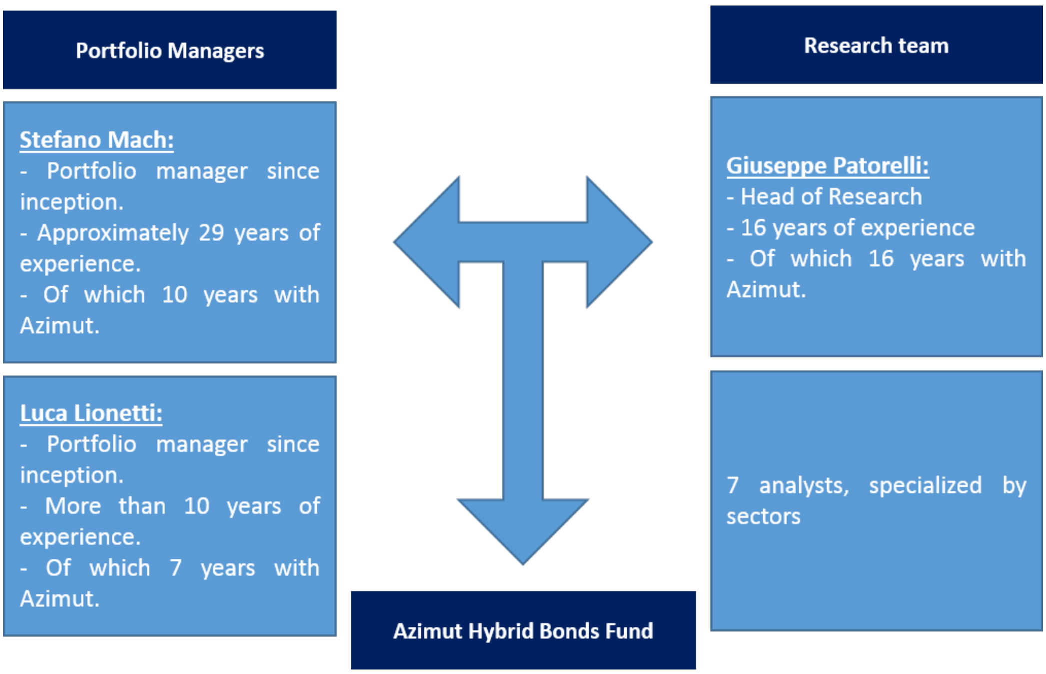
In 2013, Azimut decided to launch one of the first ever UCITS IV fund dedicated exclusively to **Euro denominated Corporate Hybrid Bonds**, shifting away from an industry trend that focused mainly on Hybrids issued by banks, mainly known as Cocos.

This pioneering stance was triggered by a move from rating agencies who redefined the regulatory framework and set new standard prospectus for Euro-denominated issuances. Under these provisions, and subject to Moody's and S&P's rating, **Euro Corporate Hybrids issuers were offered clear regulatory and accounting advantages** until the first call:

De-leveraging	Hybrids can be structured to count as equity from an accounting perspective (up to 50%)
Preserving financial profile	Only 50% of the issued amount is allocated as debt
Fiscal savings	Coupons are deductible from taxable income, generating a tax advantage

Unsurprisingly, the universe of Euro Corporate Hybrids grew steadily in the aftermath, reaching a volume size of about €130 billion. Consequently, the market breadth substantially improved, moving from a few highly leveraged utilities; to a wide spread industry and geographical diversification.

The Azimut Hybrid Bonds fund naturally benefited from the environment, gathering **assets up to U$D 2.5 billion** with a highly diversified investors base globally, managed by seasoned portfolio managers, supported by a strong research team.



II. What are Corporate Hybrid Bonds

Corporate Hybrid Bonds are subordinated debt instruments issued by non-financial companies, and are thus called 'Corporate': Typically, Hybrid bonds present the following features:

- they combine the characteristics of debt and of equity,
- they are subordinated, as opposed to Senior bonds

This is best illustrated below:

Debt	Payment of a coupon
	Issuances are rated by rating agencies (Moody's and S&P)
Equity	The coupon payment can be deferred, similar to dividends
	The issuance has no maturity date per se

Corporate Hybrid Bonds present significant differences from Cocos. The most obvious differentiating component is the <u>non-convertibility</u> of Corporate Hybrids.

As the illustration below highlights, Corporate Hybrid Bonds offer additional strong advantages to investors:

CHBs	Coupons can only be postponed	The bonds cannot be converted into equity	There cannot be a notional cut on CHBs	Average volatility of 4% - 5%
Cocos	Coupons can be cancelled	Cocos can be converted into equity	Issuer can negociate a notional cut	Average volatility of 9% - 10%

As evidenced, Corporate Hybrid Bonds bring a clear diversification proposition in terms of asset allocation, as they have different risk components.

III. How do Corporate Hybrid Bonds compare to High Yield Bonds

Hybrid issuers often have a high-quality financial profile, as they are globally Investment Grade rated. This marks a considerable difference from the High Yield Euro market, where issuers frequently have a significantly less robust financial profile. Companies that generate solid, consistent operating cash flow generally issue hybrids.

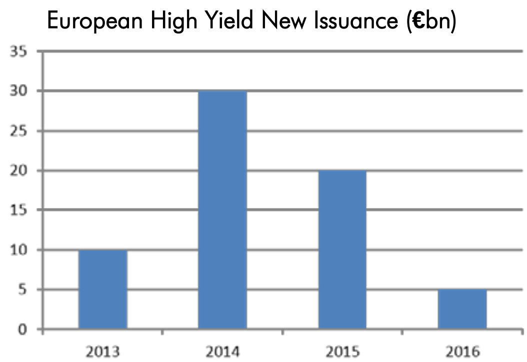
Over time, the market has also gradually opened up to non-rated companies. However, as for the Investment Grade above, the non-rated issuers tend to be high profile companies with good reputations and track record.

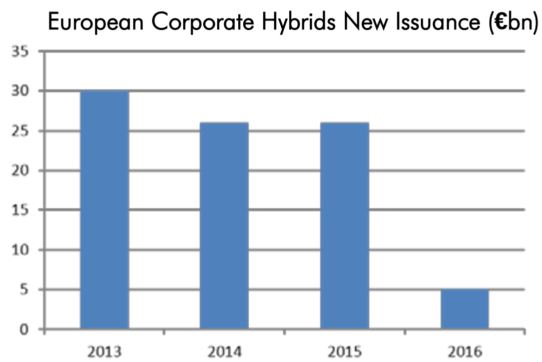
Finally, almost 90% of the Euro Corporate Hybrids issuers are listed, guarantying an easy access to companies' information for investors.

The main similarities and, most importantly, differences are highlighted below:

	Total Market	Rating Issuers	Coupon	Equity Conversion	Notional Cut	Seniority	Average Volatility
European Corporate Hybrid Bonds	130bn	IG	No cancellation	No	No	Sub	4% - 5%
European High Yield	550bn	HY	Default	No	Yes	Senior	4% - 5%

Although the High Yield universe is larger, the volume of new issuances has been slightly higher for Euro Corporate Hybrids since 2013, displaying the strong dynamics of the asset class.

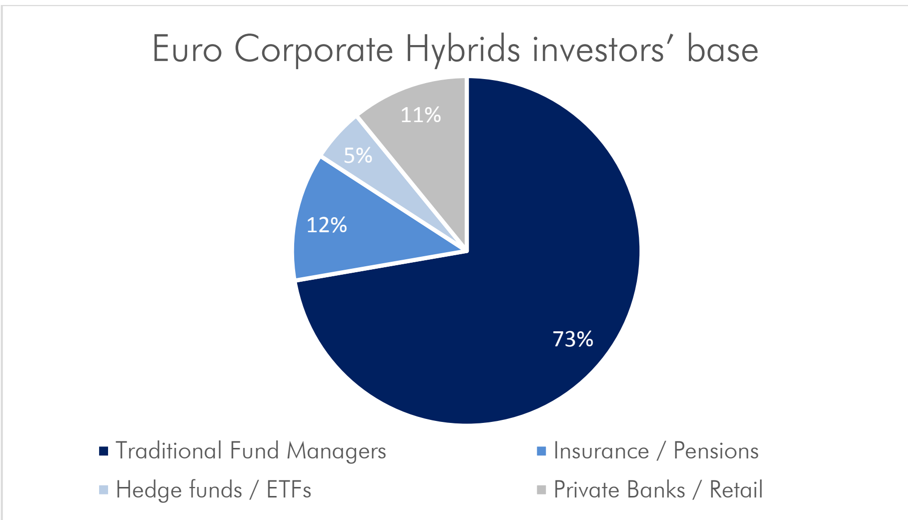




We would argue that one of the most significant difference, in favour of Euro Corporate Hybrids is one of the least visible. It lies within the nature itself of the investment universe.

It is well known and documented that the High Yield universe has seen a sharp increase in volume coming mainly from ETFs. On the contrary, the Euro Corporate Hybrids universe remained practically ignored by passive investors.

As a result, this makes the Euro Corporate Hybrids one of the very few asset classes, post ultra-accommodating monetary era, with a solid long term investors' base, hence a lower risk of liquidity squeeze in extreme market conditions.



IV. What are the risks associated with the Euro Corporate Hybrids

As with any financial investment, European Corporate Hybrid bonds have a number of risks that can largely be mitigated given the specific nature of the issuers and by a sound investment process

Risk nature	Risk Description	Risk Mitigators
Credit	Credit risk is the main common risk to all Fixed Income instruments.	This risk is low in the CHBs universe, as issuers are exclusively Investment Grade, with solid or improving financial profiles and a stable rating.
Interest rate	As for any Fixed Income instruments, a Euro CHBs whose first call date is still a long way off are more sensitive to interest rate fluctuations.	Corporate Hybrid bonds have typically a shorter duration than Senior bonds. The asset class has a low correlation with interest rates, especially when compared to European High Yield.
Subordination	Should the issuer default, the rate of recovery for the holders of hybrid securities is usually quite low as senior debt holders take priority.	Defaults by issuers with Investment Grade ratings are extremely rare.
Extension	If a Hybrid bond is not called at the first call date, the valuation of the security may fall by some 10%.	Such cases remain a last resort as issuers will lose balance sheet advantages and stuck with a floater at typically Libor + 4% to 5%. This risk for the issuer is a great incentive to call.
Deferral	The coupon payment or deferral decision is in the hands of the issuer.	This risk is very low during periods of economic growth. Also, a sound diversification of an investor's portfolio allows for lowering the negative effects of such occurence.
Volatility	Corporate hybrids are positively correlated to the equity markets. During periods of risk aversion, share prices fall and the credit spread on hybrids widens, as yields rise and hybrid prices fall.	Managing volatility can be done via both a high diversification and a thourough monitoring of durations to call.

V. Azimut Hybrid Bonds Fund

The fund aims to take full advantage of the opportunities presented by the European Hybrid Bonds market, namely offering investors:

- above Investment Grade returns,
- lower volatility than Banks Hybrids
- significantly lower risk profile than High Yield investments
- an untapped diversification to their portfolio.

To that end, the portfolio is thoroughly calibrated and monitored, presenting a set of unique key features, as described below:

	Fund characteristics		Impact for investor
Exposure	100% Investment Grade or High Profile Non-rated companies	Zero exposure to banks	1. **Unique diversification** within a Fixed Income allocation 2. **Low credit risk**
	90% of issuers are listed on a stock exchange	50% of the issuances are High Yield (issued by IG issuers)	
Diversification	**80 issuers** in the portfolio, from **20 countries**	**120 single hybrids** in the portfolio	Low risk on single Hybrids thanks to **extermely high diversification**
Liquidity	**75% of the portfolio is held by more than 65.000 individual investors**, creating a solid base.	25% of the portfolio is held by European long term high end institutional investors	Low risk of liquidity squeeze or of run-off on Hybrids or on the Azimut fund
Expertise	More than **4 years track record** and U$D 2.5 billion of assets	Highly experienced Senior management and research team	1. Sound expertise in the asset class 2. Daily liquidity 3. Stable and transparent regulation 4. Easy to register in all of major jurisdictions
	A multinational asset manager, with U$D 60 billion of AuM	**UCITS V, Luxembourg** domiciled mutual fund	
Practical information	Inception date Sept. 2013	Fees: 1. Retail: 1.20% 2. Institutional: 0.80%	**The U$D Hedged Share offers a positive 1% to 2% annual carry,** stemming from the structural differential in rates between the U$D and the Euro (1).
	Multiple shares: 1. €, $, £, ¥ 2. Accumulation, Distribution	Initial Share (€): LU0947787866 U$D Hedged: LU1232071651	

(1) Launched in September 2015, the U$D hedged share allows dollar minded investors to access the fund without currency risk.

As, structurally, U$D interest rates are higher than Euro's, the systematic hedging of the U$D share class generates a carry effect of +1% to +2% which positively affects the yearly performance and the yield of the U$D Hedged share.

As an illustration, we highlight below the 2015 and 2016 performance of the Hybrid Bonds Fund Institutional Euro and dollar shares:

	YTD Euro	YTD U$S	>0 carry effect
2016	8.4%	9.45%	+1.05%
2017	5.9%	7.9%	+2.0%

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