

Emerging markets and trade policies

The third quarter was a continuation of the second quarter, with continued emerging markets volatility, Trump's protectionist trade policies and uncertainty about the economic policy of the new Italian government being the main market drivers.

Tellus had a weak quarter in absolute terms but was slightly ahead of its benchmark index. While the return in Tellus was hurt by the volatility in emerging markets, the index was negatively affected by the higher long-term interest rates in the US and continental Europe and a depreciation of the JPY relative to EUR.

Solid growth backdrop

The global economy is growing solidly with the US economy in the driver's seat. Inflation rates are rising and we are at a stage where developed markets' central banks are in or entering a tightening phase. The US Federal Reserve has already increased its policy rate by 200 basis points and is expected to continue to do so, with the market currently pricing in one more hike in 2018 and three hikes in 2019. Norges Bank increased its policy rate in September for the first time since 2011. In addition, the ECB will most likely stop its quantitative easing programme in December alongside the Fed's quantitative tightening.

Focus on vulnerable countries

The volatility in the second quarter was initiated by a strengthening of the USD and led to a broad-based sell off in emerging market assets. In the third quarter, the volatility was more concentrated around the countries that are most vulnerable to tighter financial conditions and a stronger US dollar. These include Argentina and Turkey in particular, but also other countries with current account deficits, such as South Africa, Indonesia and India. These countries experienced sharp depreciations of their currencies and also an increase in long-term interest rates/credit premiums.

On the other hand, the market is now differentiating more between "good" and "bad" emerging market countries, with "good" countries being the ones with responsible fiscal policies, low external debt and manageable current account deficits. We believe this will continue, and that solid emerging markets countries will be among the most interesting

investment opportunities for a bond investor going forward.

Trump's tariffs

Trump has been very aggressive with regard to trade in the third quarter. In September he imposed a 10% tariff on USD 200bn more of Chinese goods and says he will increase that to 25% in 2019. Furthermore, he threatens to impose tariffs on the remainder of imports from China if China retaliates. This has already been the case, so there is a real risk of US implementing tariffs on all goods imported from China. Although most analysts believe that the tariffs already decided on will not be detrimental to growth, the threats and tone have increased the volatility in the markets.

On a positive note, by the end of the quarter the US and Mexico finally convinced Canada to agree on a new North American Free Trade Agreement (NAFTA).

Mexico – going against the tide

Mexico was the best performer in Tellus in the third quarter due to a sharp appreciation of the currency. The currency appreciated by 6.6 percent in the quarter, partly based on the expectations of a successful completion of the NAFTA renegotiations.

The fund's Norwegian investment also performed well in the quarter. We added to the position at the beginning of September, on the premise that the Norwegian krone is undervalued. The Norwegian economy has recovered from the oil crisis and the economy is growing solidly. The Norwegian krone has not appreciated along with the increase in the oil price and better growth outlook; we expect that to change going forward.

Uruguay hurt by Argentina

The largest laggards in the quarter were our investments in the Dominican Republic and Uruguay. Tighter monetary policy and a more hawkish Dominican Republic Central Bank have driven the long-term rates higher. In addition, low liquidity in volatile markets have contributed to higher long-term rates.



The negative sentiment in Argentina spilled over to Uruguay and the main risk is if a large slowdown in growth will impact Uruguay through lower exports. Photo: Bloomberg

The negative sentiment in Argentina spilled over to its close neighbour Uruguay and resulted in a sharp depreciation of the Uruguayan peso also in the third quarter. The two countries naturally have an economic relationship via trade, but otherwise their proximity is only geographical in nature. Uruguay has a strong and business friendly economy and is often said to be the Switzerland of Latin America. We see the negative sentiment as transitory. The main risk is if there is a large slowdown in growth in Argentina that will impact Uruguay through lower exports.



Trump has been very aggressive with regard to trade in Q3. He threatens to impose tariffs on the remainder of imports from China if China retaliates. Photo: Bloomberg

Portfolio changes

During the quarter, the fund increased the size of its investments in the Czech Republic and Norway. Both investments have short duration and are based on expectations of the central banks hiking interest rates ahead of the ECB, leading to an appreciation of the currencies versus the EUR. We sold out of New Zealand and reduced our holding in Spain.

SKAGEN Tellus invests primarily in bonds and certificates issued or guaranteed by governments from around the world.

The fund is suitable for those with at least a three year investment horizon. Investors must be able to tolerate currency fluctuations.

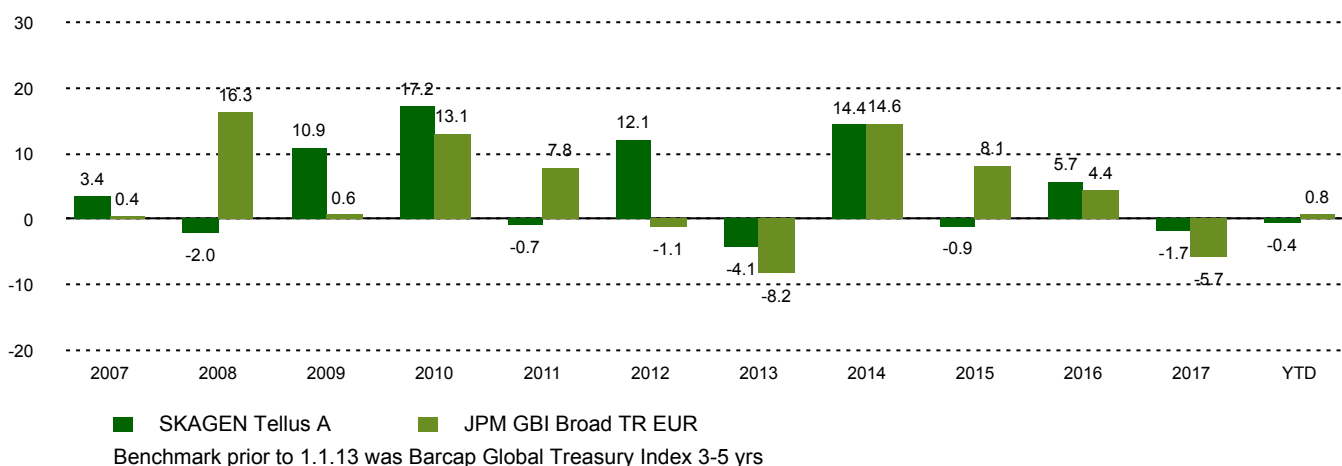
Historical performance (net of fees)

Period	SKAGEN Tellus A	Benchmark index
Last month	1.1%	-0.9%
Quarter to date	-0.2%	-1.0%
Year to date	-0.4%	0.8%
Last year	-0.5%	0.3%
Last 3 years	1.5%	0.3%
Last 5 years	2.7%	3.6%
Last 10 years	4.8%	4.1%
Since start	4.4%	3.8%

Fund Facts

Type	Fixed income
Domicile	Norway
Launch date	29.09.2006
Morningstar category	Global Bond - EUR Biased
ISIN	NO0010327786
NAV	12.06 EUR
Fixed management fee	0.80%
Benchmark index	JPM GBI Broad TR EUR
AUM (mill.)	71.45 EUR
Duration	3.29
WAL	4.70
Yield	4.76%
Number of holdings	13
Portfolio manager	Jane Tvedt

Performance last ten years



Contributors in the quarter



Largest contributors

Holding	Weight (%)	Contribution (%)
Mexican Government	7.57	0.35
Norwegian Government	11.32	0.24
US Government	14.11	0.15
Peruvian Government	4.98	0.02
Czech Republic	5.27	0.02



Largest detractors

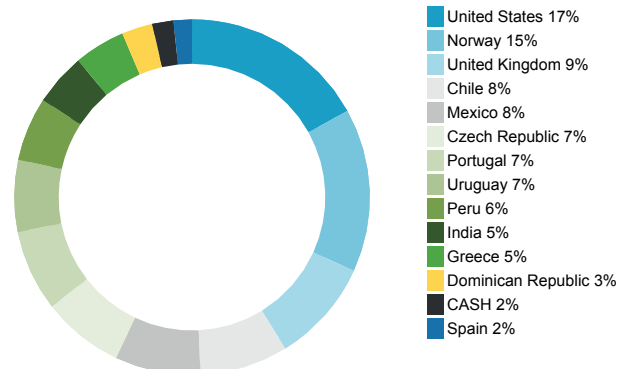
Holding	Weight (%)	Contribution (%)
Dominican Republic	5.76	-0.21
Uruguay Republic	6.69	-0.18
Asian Development Bank	4.10	-0.13
Hellenic Republic	5.66	-0.12
Portuguese Government	8.23	-0.05

All data in EUR as of 31/09/2018 unless otherwise stated.

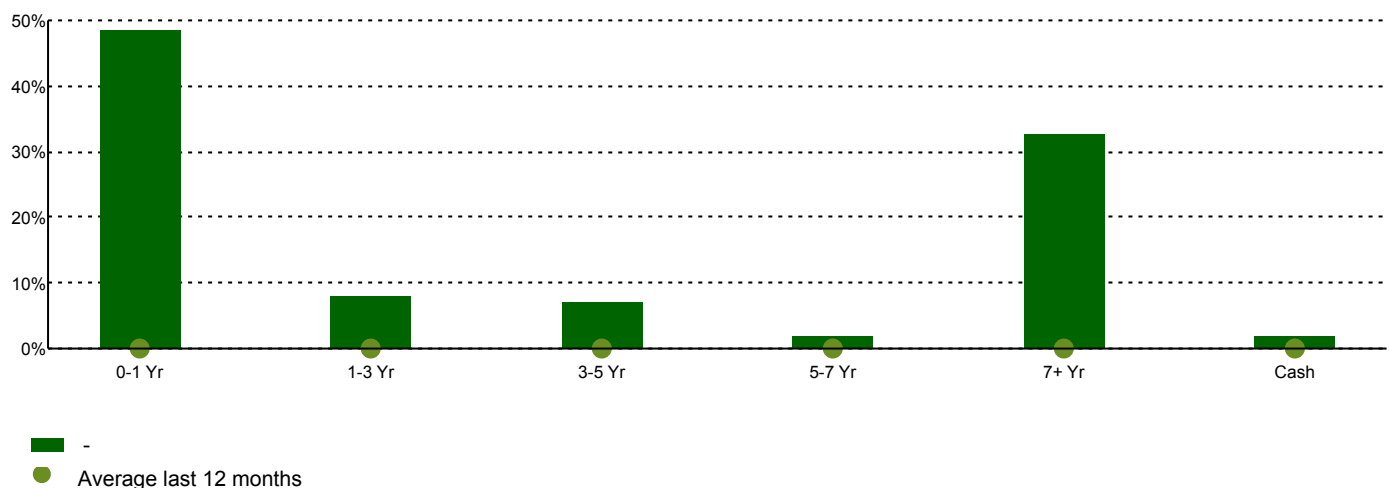
Top 10 investments

Holding	Percentage of Fund
US TREASURY N/B	16.9
Norwegian Government	14.9
UK Government	9.4
REPUBLIC OF CHILE	8.0
Mexican Government	7.8
CZECH REPUBLIC	7.4
Portugese Government	7.4
Uruguay Government	6.5
REPUBLIC OF PERU	5.8
Asian Development Bank	4.7
Total	88.9

Country exposure



Maturity structure



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Important information

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