For professional investors

ROBECO
The Investment Engineers

Financials update following recent market volatility

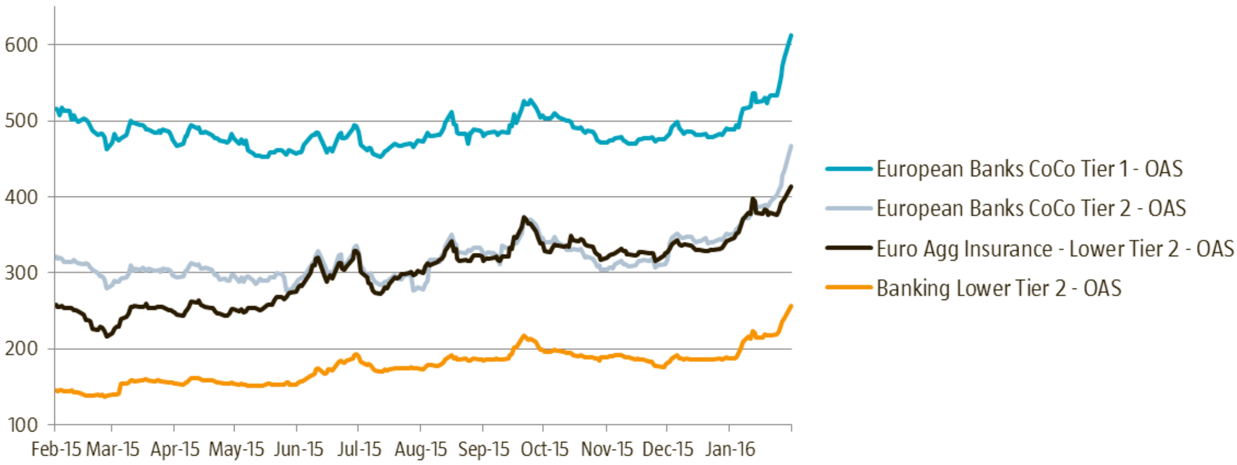
- Subordinated financials now suffering too
- Prices of AT1 CoCos down on coupon risk
- Spread widening presents a good buying opportunity

Spreads in credit markets widened last Friday, driven by the weak US payroll figures. Different negative themes have been dominating financial markets since the beginning of this year, be it Chinese currency weakness, the continuous fall in oil prices or, as in this case, fears of a slowdown in global growth.

However, this time round the subordinated financial sector suffered more than the other sectors. Subordinated bank and insurance bonds (Lower Tier 2) now offer a spread of 2.6% and 4.1% respectively. Spreads on CoCos have widened even more, to levels of 4.7% for Tier 2 CoCos and 6.1% for Tier 1 CoCos. The fund has a combined position of circa 10% in Tier 1 and Tier 2 CoCos. Despite the negative sentiment prevailing on current markets, we think the spread widening presents a good buying opportunity. Banks are benefiting from a fall in credit costs in Europe and we expect confidence in the insurance sector to increase after the publication of the first official Solvency II ratios.

Supply and demand

In this weak market environment, appetite to issue new debt is very small. Only one new bond has been issued in the Euro market so far, this was a callable Tier 2 issued by ABN AMRO. The Robeco Financial Institutions Bonds fund participated in this new deal. We expect that issuers will not return to the market until spreads have stabilized. Since the



Source: Barclays, Robeco; Data till 9 February 2016 market has cheapened a lot in the last weeks, we do expect investors to be willing to buy again in new issues.

January performance of the fund

After another strong performance over 2015 the Robeco Financial Institutions Bonds fund has faced strong headwinds in 2016. The start of the year has been pretty negative for risky assets. Although subordinated debt of banks and insurance companies did benefit from the decline in underlying government bond yields, the negative impact of higher spreads was larger. Spreads for the benchmark widened from 246 basis points to 285 basis points and the excess return of the asset class was -2.29% in January. The return[1] of the fund was negative and the performance lagged that of the benchmark. The underperformance can be explained by the fund's overweight beta positioning.

Although the performance of financials was negative, on a risk-adjusted basis banks still outperformed the market. This cannot be said for insurance bonds, where the performance was a bit weaker. Looking at individual segments of the market, it is clear that Additional Tier 1 CoCos could no longer maintain their status of safe haven. These bonds were the worst performers in terms of excess returns. On a risk-adjusted basis, this part of the market still outperformed other segments. Prices of AT1 debt fell because of worries about coupon risk, and the sell-off in bank shares did not help either. Biggest victims were Deutsche Bank, Banco Popular and Unicredit. The fund does not hold any positions in these names. Italian banks in general had a very tough month on worries about the scale of the stack of non-performing loans in the country. We only hold insurance debt in Italy.

Annualized returns Robeco Financial Institutions Bonds[1]	31-Jan-16			
	1-Year	2-Year	3-Year	Since Jun-11
Robeco Financial Institutions Bonds	-0.80%	4.27%	6.57%	8.28%
Benchmark*	-1.20%	3.72%	5.71%	6.65%
Relative Performance	0.40%	0.55%	0.86%	1.63%
Information Ratio	0.52	0.78	1.12	1.22
Tracking Error	0.78%	0.70%	0.77%	1.34%

Calendar year returns Robeco Financial Institutions Bonds					
	YTD	2015	2014	2013	2012
Robeco Financial Institutions Bonds	-1.17%	2.04%	9.32%	8.99%	34.20%
Benchmark*	-0.85%	1.12%	8.94%	7.27%	32.50%
Relative Performance	-0.32%	0.92%	0.39%	1.73%	1.70%

[1]Robeco Financial Institutions Bonds DH EUR, return gross of fees in EUR,* Benchmark: Barclays Euro-Aggregate: Corporates Financials Subordinated 2% issuer constraint (EUR), Source: Robeco Global Performance Measurement

Management expectations

We believe that financials can act as a safe haven in the current environment of increased macro risks. Banks are benefiting from a fall in credit costs in Europe and we expect confidence in the insurance sector to increase after the publication of the first official Solvency II ratios. Following a statement of the European Banking Authority in December, it is clear that some banks do not have that much leeway before supervisors will start to interfere with coupon payments on Additional Tier 1 CoCos. We think any coupon cancelation in 2016 is unlikely, but it will certainly become more of a topic for discussion. Only 6% of the portfolio is invested in this kind of instruments.

Another theme will be the implementation of the European Bank Recovery and Resolution Directive. In more and more cases bondholders will suffer if a bank needs to be resolved. We have seen recent examples of such bail-ins in Italy and Portugal. Thorough issuer selection is key. We are only investing in banks that either have solid capital ratios or whose capital ratios are on a clear path of improvement.

By Jan Willem de Moor, Lead portfolio manager Robeco Financial Institutions Bonds fund

Important information