Global Bond Fund

Russell Investments

Q1 2020 Quarterly Review

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Senior Portfolio Manager,
Head of Fixed Income

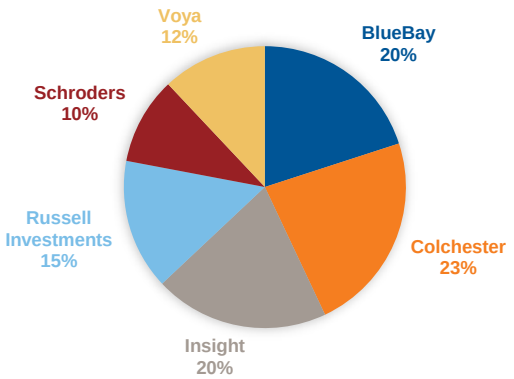
April 2020

Russell Investments Global Bond Fund

Gerard Fitzpatrick, Senior Portfolio Manager, Head of Fixed Income
12 years with Russell Investments

Fund objective: Consistently outperform the global investment grade bond market using a diversified, multi-manager approach

Manager allocation



Focus	Benchmark	Launch date	Fund size
Broad Market Global Bonds	Bloomberg Barclays Global-Aggregate Index ($NZ Hedged)	23 February 2010.	NZD $2.1 Billion[1]

[1] Total fund AUM
Source: Russell Investments. AUM data as at 31 December 2019. The weights shown are strategic weights for this Fund

Global Bond Fund

The core fixed income component of your multi-asset portfolio

Objective:

- Achieve long term growth by investing in global debt instruments including governments, corporate, agency and securitised and as well as currency instruments.
- Aims to achieve over a cycle 100 bps p.a. excess return over the Bloomberg Barclays Global Aggregate Bond Index (USD) - Total Returns.

Portfolio construction is informed by our strategic beliefs:

- **Term Risk Premium** - We believe longer-term bonds will generate higher returns than comparable shorter-term bonds or cash. These higher returns result from expectations of future interest rates, liquidity preferences and practical constraints on borrowers and lenders.
- **Credit Risk Premium** - We believe that bonds with credit risk will generate higher returns than those of comparable high-quality government securities over a market cycle.
- **Active Manager Skill** - We believe that skilfully selected active managers can add value over passive investments
- **Currency Factors** - We believe currency can generate higher returns than cash through the use of systematic strategies. The currency factors are carry, valuation and trend.
- **Rates Factors** - We believe systematic long/short government bond strategies can generate higher returns than cash. The interest rate factors are carry and value. These two factors respectively look at the slope of yield curves and the real yield on government bonds to determine their systematic positioning.
- **Bond Illiquidity Premium** - We believe that there is an illiquidity premium for bond securities via a price discount or excess return/yield offered by the security relative to a liquid security with otherwise equivalent characteristics.

Source: Russell Investments. Any forecast, projection or target is indicative only and not guaranteed in any way.
Notes: Some investments/bonds may not be liquid and therefore may not be sold instantly. If these investments must be sold on short notice, you might suffer a loss. The Fund is actively managed with reference to the Bloomberg Barclays Global Aggregate Bond Index (USD) - Total Returns. The Fund's performance will be measured against the Index which it seeks to outperform by 1% over the medium to long term.

Global Bond Fund

Utilise a range of strategies to achieve desired positioning

Return Drivers	Colchester 23%	Schroders 10%	Voya 12%	BlueBay 20%	Insight 20%	Proprietary Strategy 15%	Fund
Governments							
Investment Grade Credit							
Securitized							
High Yield Credit							
Emerging Market Debt							
Currency							

Low — Contribution to expected excess return — High

Source: Russell Investments, 31 December 2019. The Fund is actively managed with reference to the Bloomberg Barclays Global Aggregate Bond Index (USD) - Total Returns. The Fund's performance will be measured against the Index which it seeks to outperform by 1% over the medium to long term. Russell Investments and/or the money managers may manage a portion of the Fund with reference to a benchmark which is not the Index. Any such benchmarks used will be relevant to each Russell Investments and/or money manager strategy and may be used as the basis for portfolio constraints or for performance measurement purposes. Any such constraints are not expected to materially constrain the relevant portfolio from being managed on a fully discretionary basis

Q1 2020 Market Review – Rates

Rates

- **10-year Treasury yield decreased to record low levels – down 125bps to 0.67%**
  - The Fed dropped interest rates to a range of 0 to 0.25%, down from a range of 1 to 1.25%. It also added an extra $700 billion in asset purchases, expanded repurchase operations, dollar swap lines with foreign banks and included credit facility for commercial banks to ease household and business lending. Fed also brought forward a new temporary facility for foreign and international monetary authorities (FIMA), which is an initiative that enables central banks and public institutions around the world use their existing stock of US Treasuries to get access to dollars.
  - US jobless claims jumped to 3.28 million in the week ending March 21st- the highest print since the series began in 1967 - accommodation and food services sector was the hardest hit
- **Yields of the benchmark UK 10-year gilt decreased 46 bps to 0.36% whilst the German 10-year bund fell 28 bps to -0.47%.**
  - Bank of England slashed its interest rate to a record low of 0.1%, as well as expanded its quantitative easing programme by £200 billion
  - European Central Bank (ECB) unleashed an emergency €750 billion package (Pandemic Emergency Purchase Programme). A self-imposed limit to buy no more than a third of any country's eligible bonds, will not apply to the extra €750 billion of bonds the ECB committed itself to buying
  - Peripheral spreads widened initially but tightened back again after the ECB announced their Pandemic Emergency Program including significant purchases of peripheral bonds. 10-year BTP-Bund spreads rose to 278bps at the peak in mid-March, from 170bps at the end of February and ended the month around 200bps.
- **Yields of the 10 year JGB climbed 3bps to 0.02%**
  - BOJ governor Kuroda held interest rates at record levels and said the BOJ will provide ample liquidity injections to help maintain market stability, as well as double purchases of exchange traded funds.

Source: Bloomberg as of 31 March 2020.

Q1 2020 Market Review – Credit

Credit

- **Global investment-grade (IG) credit spreads widened by 149 bps to 241 over a tumultuous quarter. Both US HY widened sharply 544 bps to 880bps whilst EU HY widened 489 bps to 782 bps as investors fled towards more perceived "safe-haven" assets**
  - Covid-19 pandemic forced most developed markets to go into lockdown. This ensured the closure of non-essential businesses, which will translate into the deep contraction of the global economy, increase unemployment and potentially engender a depression.
  - Governments unleashed large fiscal stimulus programmes to match central bank actions and address the adverse effects of the coronavirus. The US for example, managed to agree to a $2.2 trillion fiscal stimulus deal. This unprecedented package includes $350 billion in support for small businesses, along with $1,200 direct payments to lower- and middle-income adults and $500 per child. The UK revealed several packages including a job retention scheme that pays up to 80% of employees' salaries. Eurozone governments, including Germany, have promised similar deals.
  - Global credit spreads have widened to above 90th percentile levels when compared to the last 20 years of spread data.
  - Market liquidity across all financial assets has become impaired which has been recognised by central banks who are introducing policies to alleviate some of the strain.
  - Many companies lost their investment-grade status. Ford became the largest 'fallen angel' to date, after Moody's and S&P Global stripped the company of its investment-grade credit rating.
  - Surprisingly, despite the increase in spreads, corporates have continued to issue, often at a premium to market levels. New issuance was mixed but many quality companies did come forward to the markets. Some notable deals came from Nike ($6.0 billion), McDonalds ($2.75 billion) and Coca Cola ($5.0 billion).
  - Hard currency EMD declined 11.8% and corporate EMD decreased 10.2% over the period (USD terms).
  - Securitised sector was hit particularly hard, particularly those with underlying assets in accommodation and retail sectors, and hence CMBS has seen material negative returns. Furthermore the potential idea of mortgage holidays has brought pressure to the non-agency sector, as well as the lack in any specific buying program for non-agency securities.

Source: Bloomberg as of 31 March 2020. Notes: Spread data sourced from corresponding Bloomberg Barclays indices.

Q1 2020 Market Review – Currency

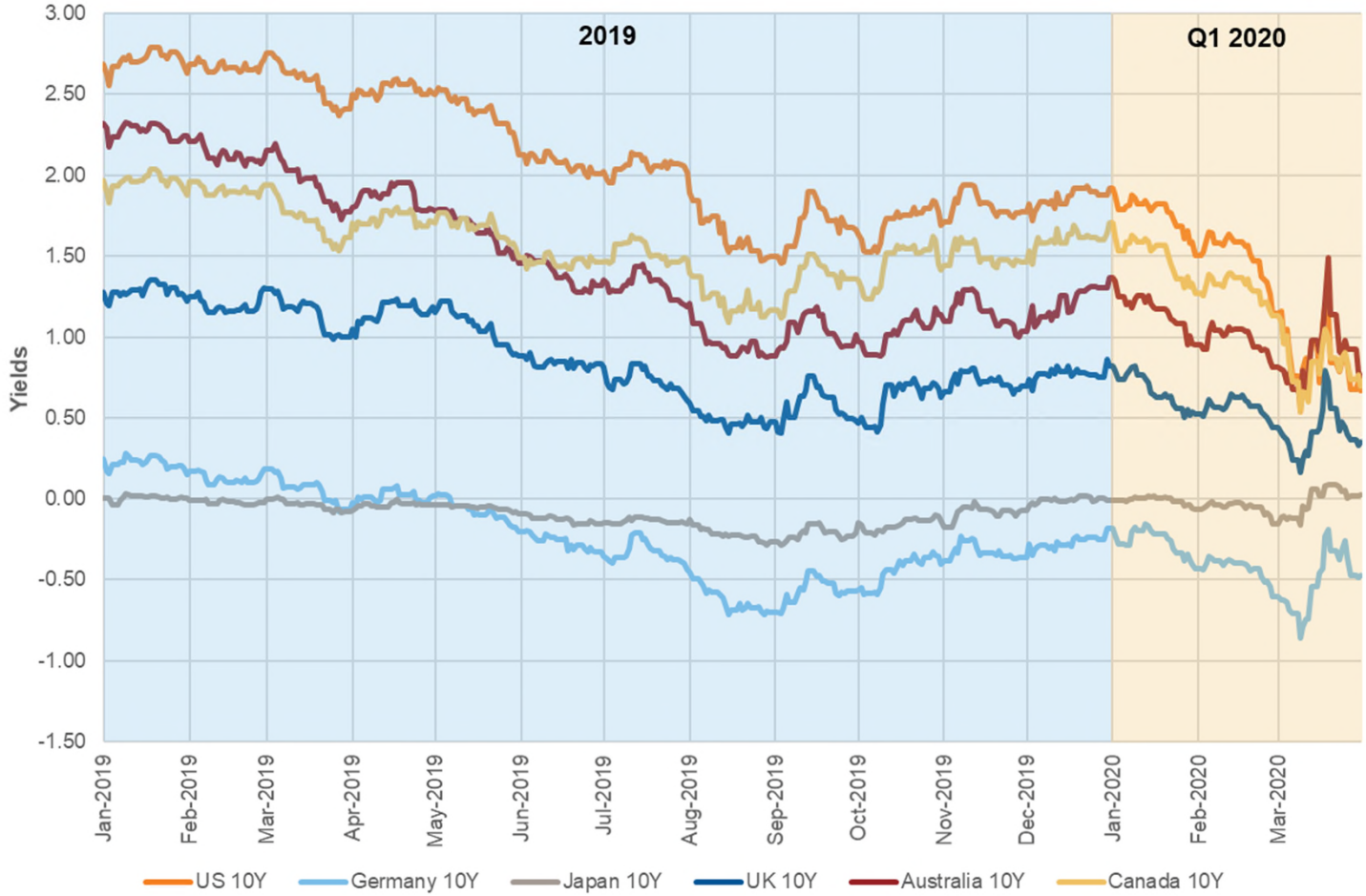
Currency

- **Greenback strengthened over the quarter, as investors prized its perceived "safe haven" status**
  - There was massive demand for US dollars as much of the world's credit is denominated in US dollars. The Fed attempted to meet this extraordinary demand for US dollars with the establishment of FIMA.
  - The strength of the US dollar weighed on a basket of currencies, notably Emerging Market (EM) ones. sharp decline in oil prices and lack of demand for other major commodities, was another major detractor for EM currency strength.
  - Consequently, major commodity-exporting countries saw their currencies weaken against the greenback, namely the Brazilian real, South African rand, Russian rouble and Mexican peso.
  - There were episodes in the early days of the selloff where the defensive characteristics of the Japanese yen were called into question, yet the yen did finish the quarter slightly stronger than the US dollar.

Source: Bloomberg as of 31 March 2020. Notes: Spread data sourced from corresponding Bloomberg Barclays indices.

Rates – 10Y Yields

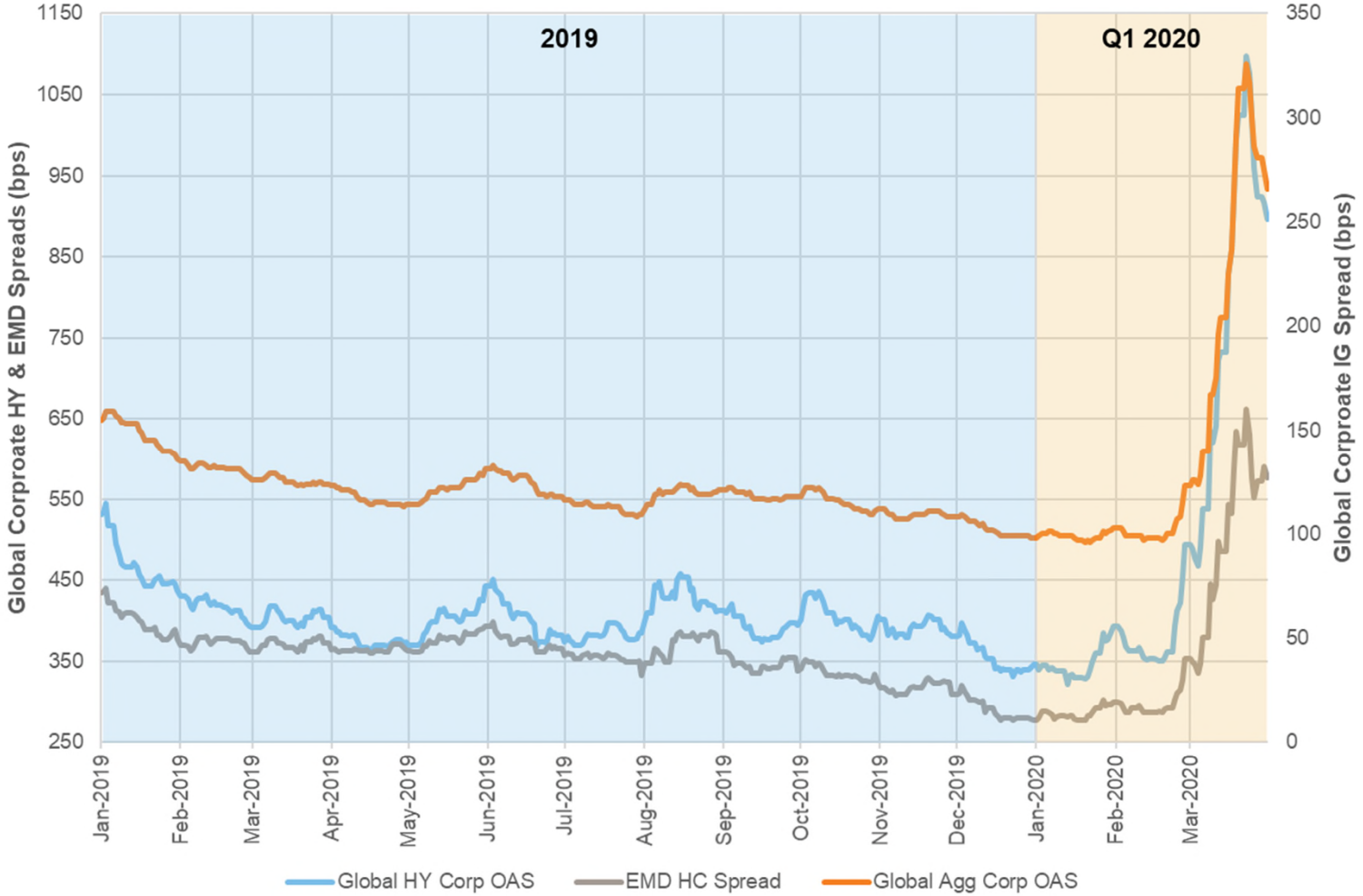
Yield convergence: Sharp falls for higher-yielding countries



Source: Bloomberg as at 31 March 2020.
Note: Any past performance is not necessarily a guide to future performance.

Credit Spreads

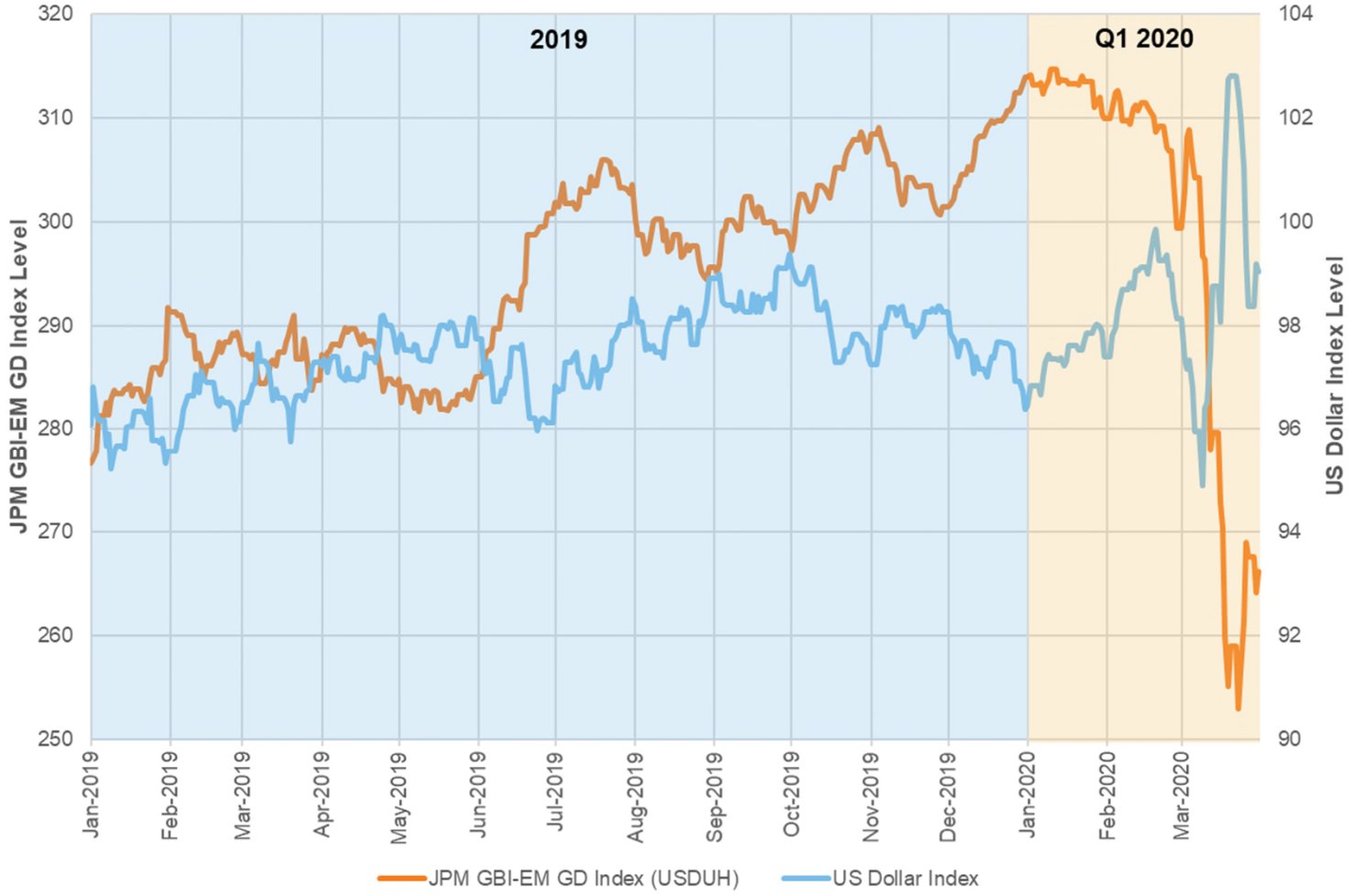
Unprecedented pace of blowout in credit spreads



Source: Bloomberg as at 31 March 2020.
Note: Any past performance is not necessarily a guide to future performance.

Currency

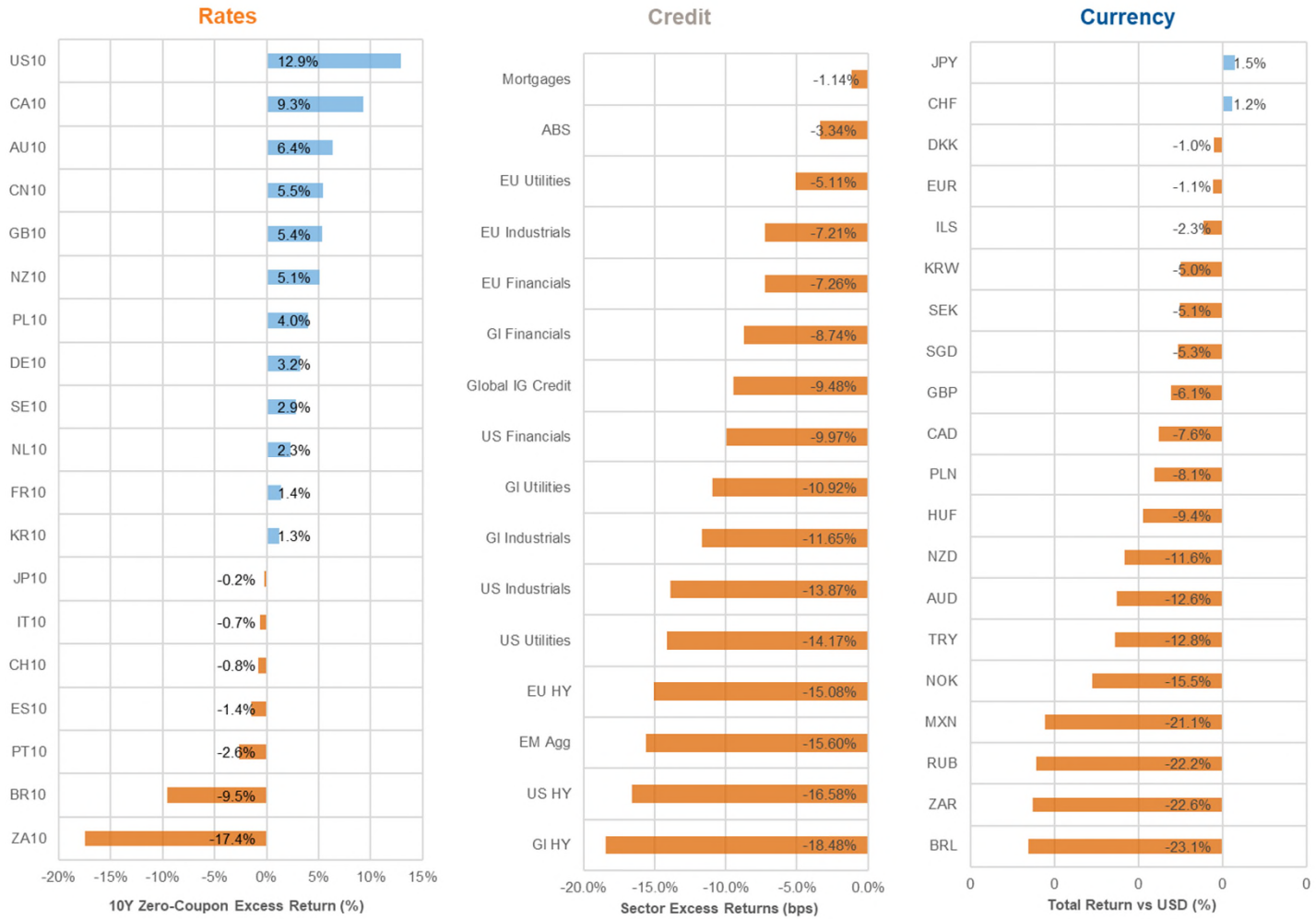
Dollar reassumes strength; EM currencies feel pain



Source: Bloomberg as at 31 March 2020.
Note: Any past performance is not necessarily a guide to future performance.

Rates, Credit, Currency

Q1 2020



Source: Bloomberg as at 31 March 2020. Any past performance is not necessarily a guide to future performance. Any reference to returns linked to currencies may increase or decrease as a result of currency fluctuations. Notes: Rates: Derived from Bloomberg zero-coupon yields. Credit: Bloomberg Barclays excess returns. Currency: All TR indices except for RUB (JGENFXRU) and ILS (ILSUSD). Source: Bloomberg.

Russell Investments Global Bond Fund

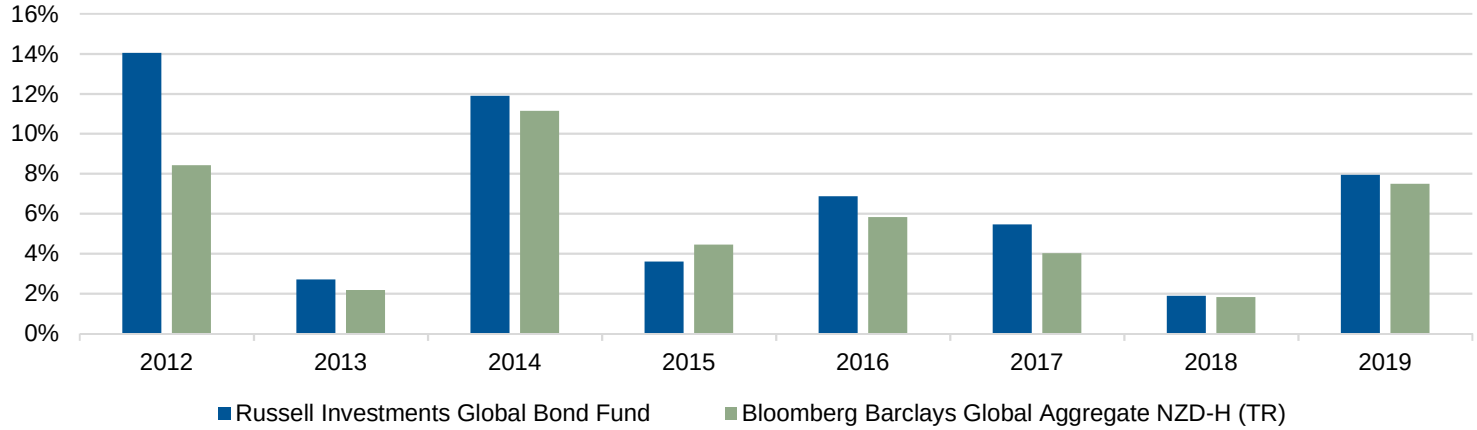
Performance history

Trailing performance as at 31 March 2020

HOLDING	1 MONTH	3 MONTHS	YEAR-TO-DATE	1 YEAR	3 YEARS P.A.	5 YEARS P.A.	SINCE INCEPTION P.A.	TRACKING ERROR (3 YEARS)	INCEPTION DATE
Gross returns	-4.03%	-0.61%	-0.61%	4.51%	4.31%	4.37%	6.50%	1.52%	23 Feb 2010
Benchmark[1]	-1.67%	1.36%	1.36%	6.02%	4.62%	4.38%	5.65%		
Excess return	-2.36%	-1.97%	-1.97%	-1.51%	-0.32%	-0.01%	0.85%		
Net returns[2]	-4.10%	-0.80%	-0.80%	3.71%	3.50%	3.54%	5.58%		

[1] Bloomberg Barclays Global Aggregate Index New Zealand dollar hedged
[2] Net returns assume the highest fee (management expense ratio)

Calendar year performance (gross of fees) to December 2019



*Returns are denominated in NZD
Source: Confluence, Morningstar, Russell Investments as of 31 Dec 2019.
Past performance is not a reliable indicator for future performance

Global Bond Fund

Q1 2020 – Main drivers of performance

Contributors

- **Rates strategies**
  - Overweight to US duration performed strongly.
- **Credit strategies**
  - Underweight to IG industrials and IG utilities.
  - Underweight to EMD hard currency
  - Underweight to government related, covered bonds and agency RMBS.
- **FX strategies**
  - Underweight to NZ and Australian dollar through Colchester and FX factors.
  - Underweight to Thai baht through Colchester.
  - Underweight to Hungarian forint through Colchester.

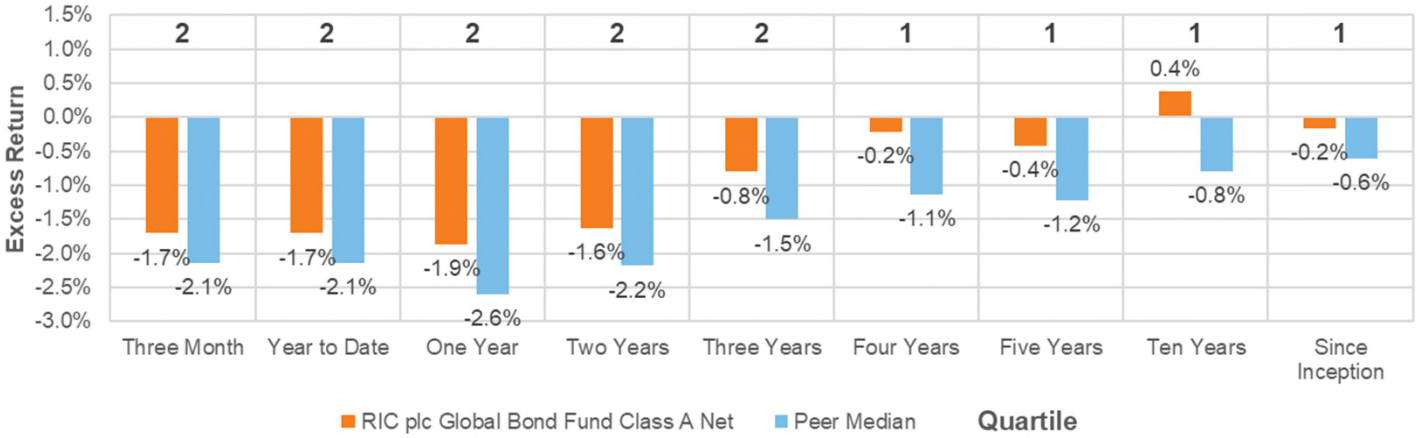
Detractors

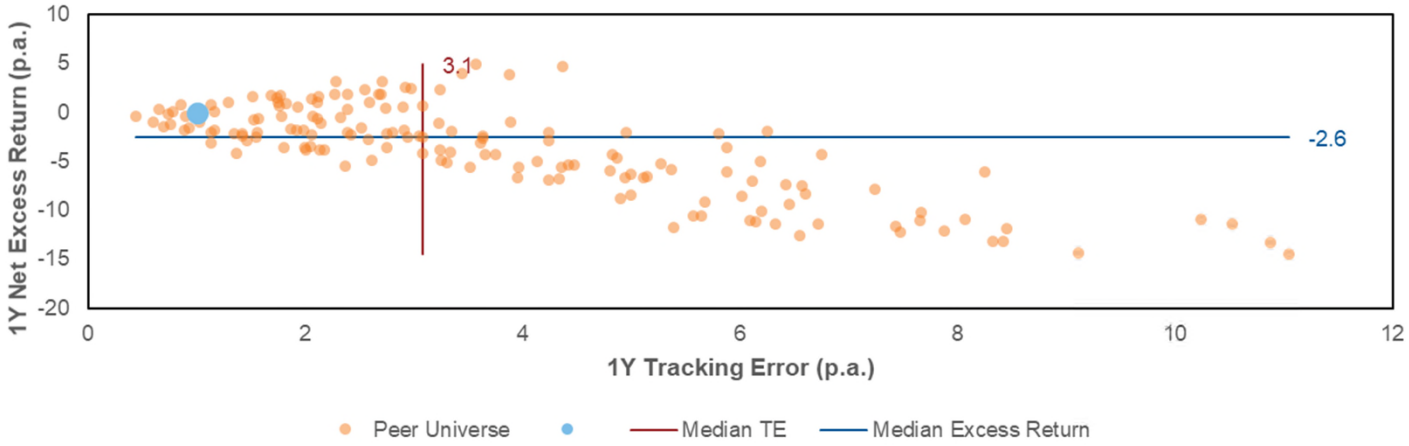
- **Rates strategies**
  - Underweight UK, Canadian and Australian duration.
  - Underweight Chinese duration, overweight Brazilian duration (Colchester and Voya).
- **Credit strategies**
  - Overweight to securitized assets, primarily via Schroders and Voya. This includes CMBS, ABS and non-agency RMBS.
  - Generic overweight to credit, in line with the model FI portfolio, implemented primarily via credit derivatives.
  - Overweight to IG financials, primarily via BlueBay and Voya.
  - Overweight to corporate high yield, primarily via BlueBay and Insight.
- **FX strategies**
  - Underweight to the US dollar, primarily through Colchester.
  - Overweight to Mexican and Colombian peso primarily through Colchester.
  - Overweight to the British pound, Norwegian krone, and Swedish krone

Source: Russell Investments as at 31 March 2020.

Peer Relative Return & Risk

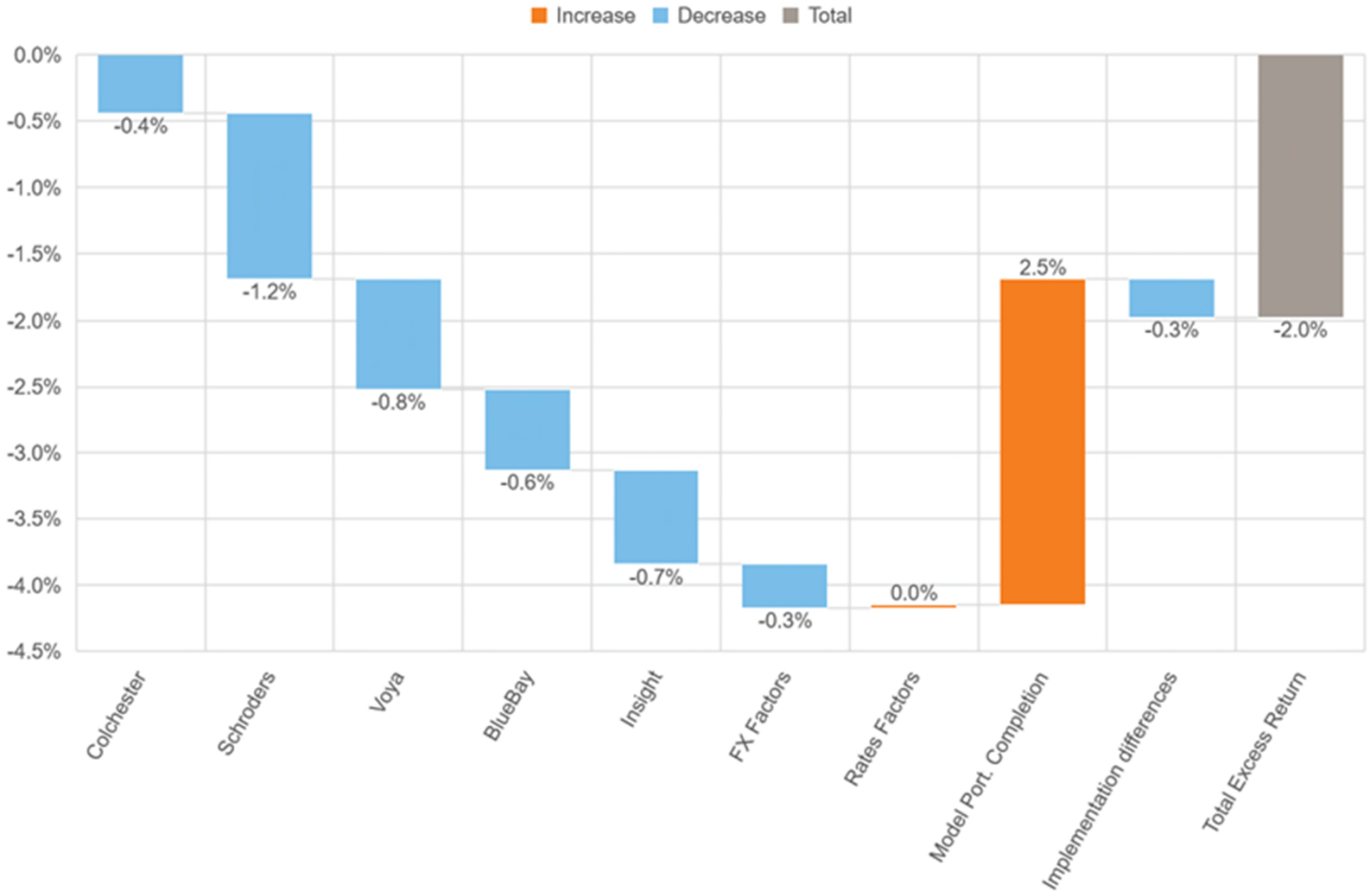
RIC Global Bond Fund A vs. Morningstar EAA OE Global Bond Peer Universe





Source: Confluence and Morningstar, 31 March 2020. Notes: Some investments/bonds may not be liquid and therefore may not be sold instantly. If these investments must be sold on short notice, you might suffer a loss. Morningstar EAA open-end Global Bond Peer Universe. The Fund is actively managed with reference to the Bloomberg Barclays Global Aggregate Bond Index (USD) - Total Returns. The Fund's performance will be measured against the Index which it seeks to outperform by 1% over the medium to long term.

RIML GBF Q1 contribution by strategy



Source: Russell Investments, scaled manager-provided data, as at 31 March 2020.

Global Bond Fund

Deep dive into underlying strategies

Investment Strategy	Key drivers of excess return
Colchester	• Short duration bias (underweight to the US, UK and European duration) weighed on performance, while overweight to Singaporean and Norwegian rates helped. • In FX, a sizable overweight to the Norwegian krone, Mexican and Colombian peso were negative while underweights in Australian dollar, Thai baht, Hungarian forint and Euro buoyed FX returns slightly. • Overall, structural underweight to credit was the main source of value add.
Schroders	• Material underperformance market volatility uncovered the inherent illiquidity in securitised markets. CMBS was hit particularly hard as concerns over office space and retailer backed loans abounded.
Voya*	• The lion's share of underperformance was from an overweight to the securitised sector, specifically in CMBS. • Exposure in EM hard currency sovereigns and corporates detracted, as well as smaller positions in IG and HY exposures. • Small overweight to US and European duration added slightly. • FX positions also detracted with an overweight to the Euro, Norwegian krone.
BlueBay	• In rates positioning, underweight to UK rates was a material detractor, however an overweight to Hong Kong, France , Greece and German rates was additive. • Primary source of underperformance however was from overweight to corporate HY exposure, emerging markets names and financials. • FX also detracted via overweight to EM FX including the Russian ruble, Brazilian real, Mexican peso and Hungarian forint.
Insight	• Small positive as they added to duration as the quarter progressed but large underperformance from long US and Euro inflation breakeven exposures. • Significant negative due to overweight in Italy, Spain and Greece relative to Germany and short position in US treasuries vs. Japanese government bonds. • Modest overweight in IG spreads and enhanced money market instruments was also negative. • Modest negative due to overweight in EMD hard currency, as well as overweight in local currency Brazil, Mexico and Indonesia.
Model Portfolio completion	• Additional duration exposure was positive along with US/German 10yr spread narrower and long JPY vs USD. • Additional credit exposure was negative.
Russell Investments Proprietary Strategy	• The FX factors underperformance was driven largely by an overweight to the GBP which came from the Trend factor. Also, overweights to the pro-cyclical SEK and oil-related CAD caused further underperformance. An underweight to the NOK buoyed FX returns. • The Rates Factors outperformed this quarter primarily driven by an overweight to the US duration. These gains were held back by underweights to Australia and Canadian duration, as well as an overweight to Japanese rates which nudged slightly higher.
Fund	

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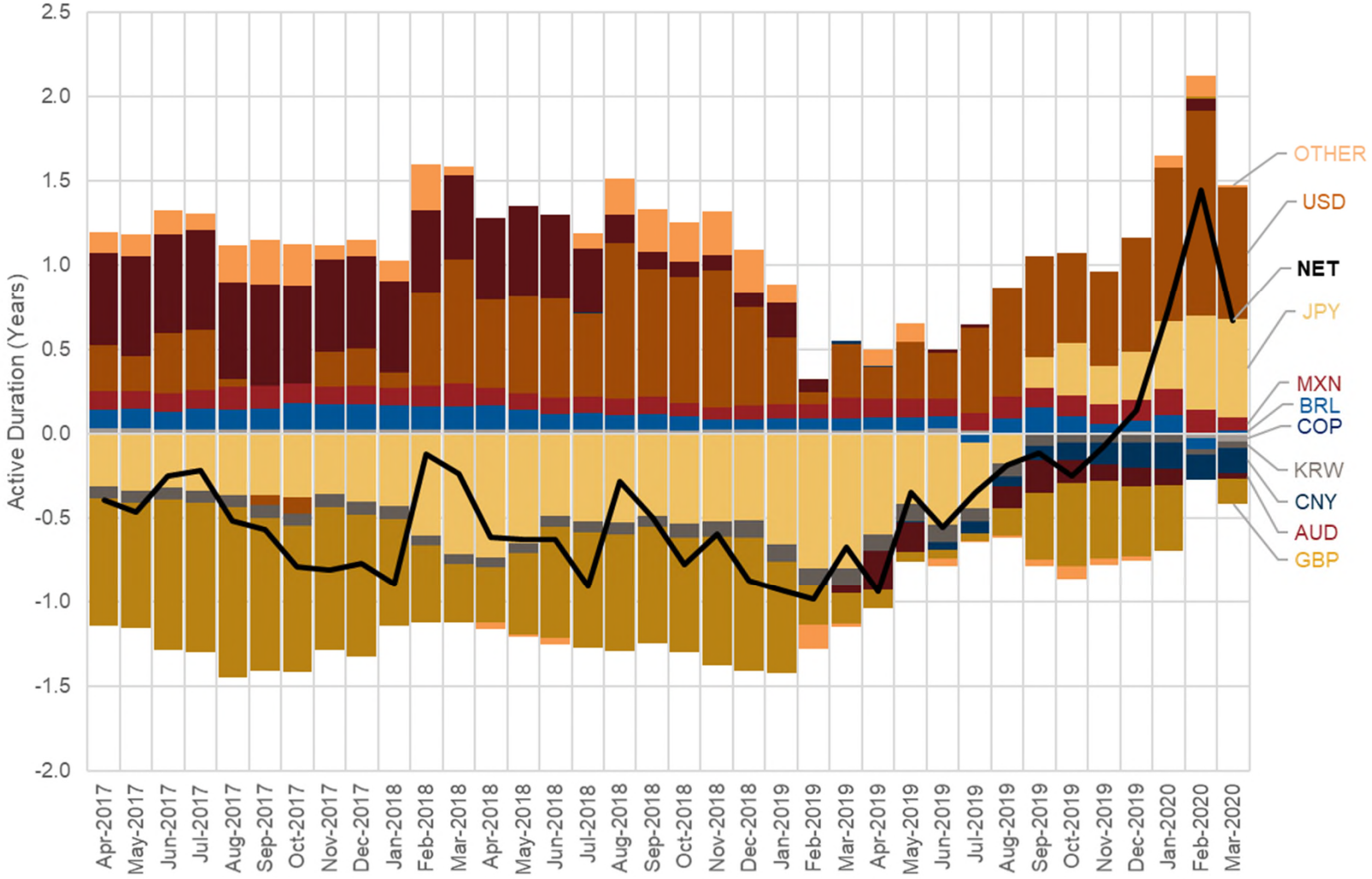
Global Bond Fund active duration positioning

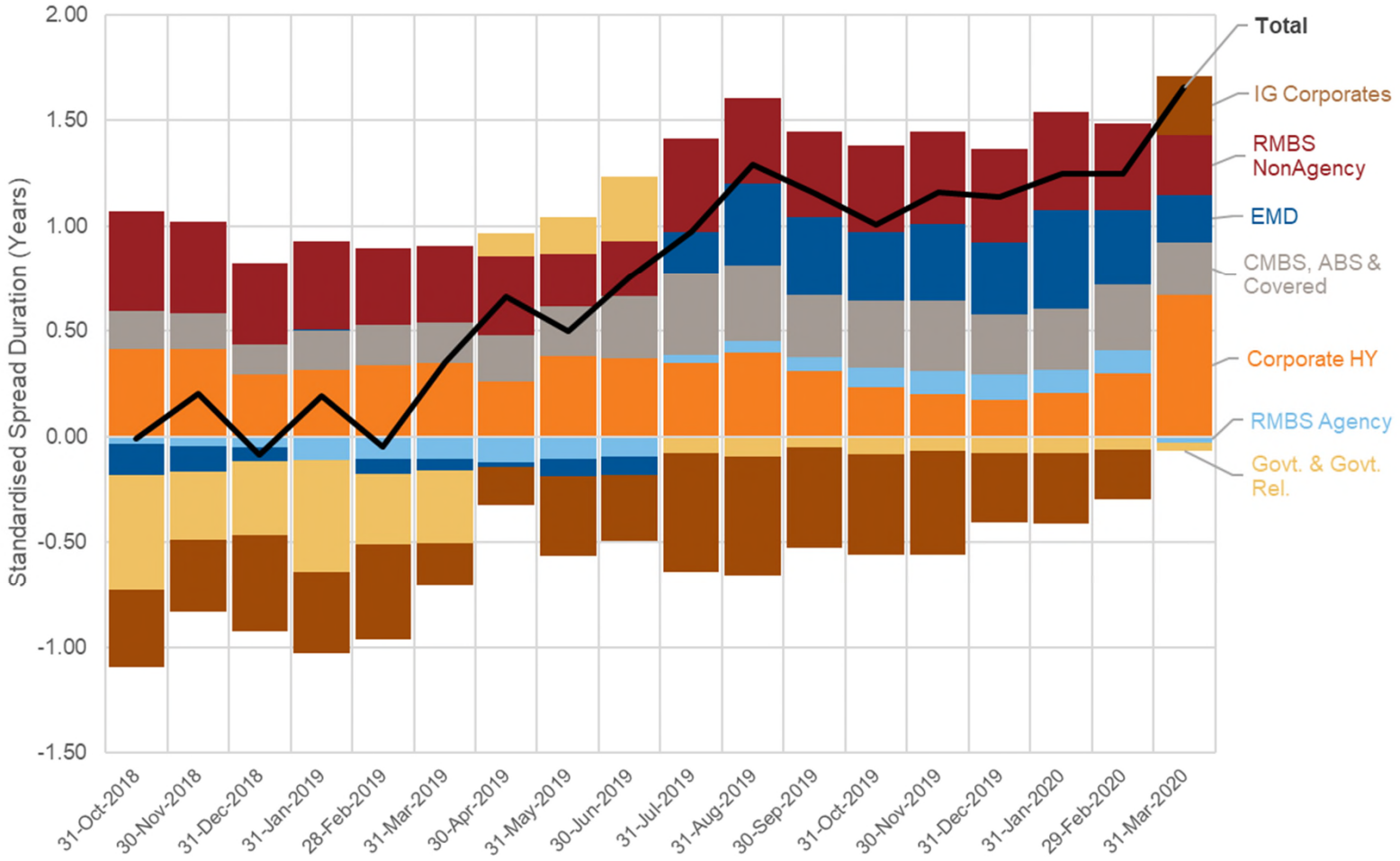
Preference for US and EM duration



Source: FactSet, Bloomberg Barclays, as at 31 December 2019.

GBF active sector positioning

Std. spread duration incrementally with more attractive credit spreads



Source: Russell Investments, as at 30 March 2020. Standadised spread duration is the equivalent spread duration in US IG corporates.

Outlook

- **The COVID-19 virus has stalled the mini-cycle rebound and made a global recession likely.** While the duration of the virus pandemic is unpredictable, policy stimulus, pent-up demand and a lack of major imbalances argue for a solid upswing when the virus threat clears.
- **Our central case is that global growth begins to recover in the second half of the year as the virus outbreak fades.**
- **The combination of monetary and fiscal stimulus on top of last year's easing, combined with the reduction in China-U.S. trade tensions, argue for a solid recovery when the virus threat recedes.**
- **However, there are risks to this view of an economic recovery in Q3, including:**
  - The progress of the virus can't be forecast. The number of cases in the U.S. may be under-reported, and there could be a dramatic escalation in confirmed cases. The containment measures may be more drastic, and the recession could continue into Q3.
  - The economic impact of the virus may turn out larger than expected. There is evidence that labour markets have already been damaged, and the shock to consumer and business confidence could generate a self-sustaining economic downturn. There could also be a credit-market event that leads to rising defaults and liquidity issues, which in turn creates fears of a 2008-style downturn.
  - Global supply chain disruptions may have a larger and more sustained negative impact on global growth. Central banks have limited firepower compared to previous recessions. The U.S Federal Reserve, Bank of England, Bank of Japan and European Central Bank (ECB) are already at the zero-lower bound
  - Central banks have limited firepower compared to previous recessions. The U.S Federal Reserve, Bank of England, Bank of Japan and European Central Bank (ECB) are already at the zero-lower bound**.**
- **A re-run of the 2008 financial crisis seems unlikely.**
  - Tier 1 capital ratios2 for large U.S. banks are significantly improved from 2007 and should cushion against the risk of a severe drawdown.
  - Bank mortgage lending has been prudent.
  - Consumer balance sheets are reasonably healthy. It's true that central banks have less scope to cut interest rates, but if needed they can turn to quantitative easing and other unorthodox policies.
  - There also will be substantial political pressure on governments to provide fiscal stimulus**.**

Source: Russell Investments as at December 2019.

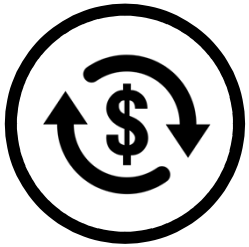
Scenarios

Difficult to assess. Low probability assigned to bear case due to:

- Magnitude of equity market falls so far
- Size of policy response being put together

Bull (45%)

Strong recovery as containment measures and fiscal backstops succeed in Q2. Pent-up demand and policy stimulus drive sharp fundamental recovery.



Neutral (45%)

U-shaped recovery. Fiscal backstops blunt the blow but corporate stress and labor markets weakness drive a more normal (12m) economic recession. The recovery from Q3 is more gradual.

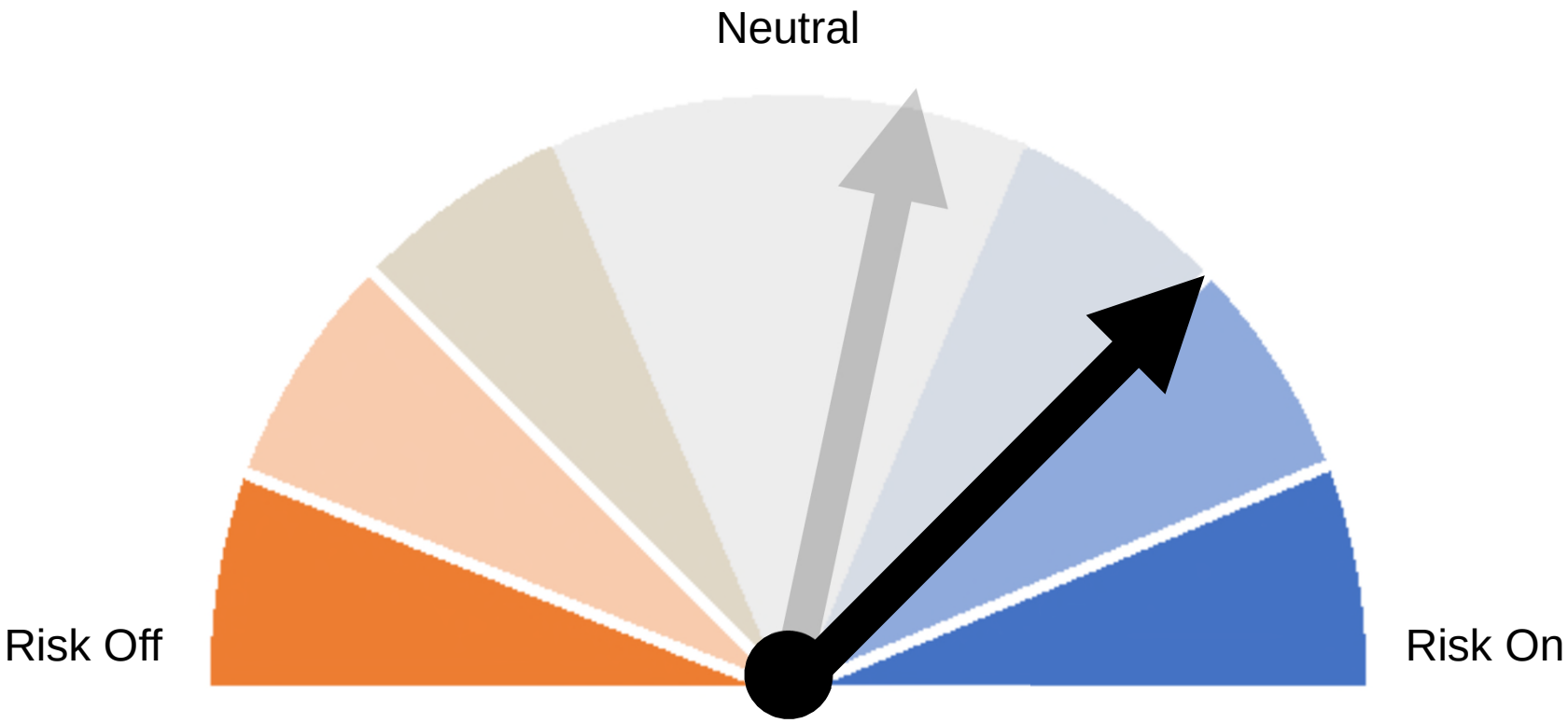
Bear (10%)

Containment measures continue into Q3 as virus persists through the Northern summer. Full-blown credit crisis. Record corporate debt creates a GFC-like event.

Source: Russell Investments, for illustrative purposes only.

Risk on/off speedometer

Stage 2 risk-on



SOURCE: Russell Investments, 17 March 2020

Sources of value add

A strong transparent process

Open Architecture Approach

Strategic Beliefs

- Term Risk Premium, Credit Risk Premium, Active Manager Skill, Currency Factors, Rates Factors, Bond Illiquidity Premium

+ 1.0 years duration
+1.7 years std. spread duration*

Strategy Selection

- Managers selection and allocation management, Russell Positioning Strategies

BlueBay, **Colchester**, **Insight**, **Schroders**, **Voya**, **Rates Factors** (Carry, Value), **FX Factors** (Carry, Value, Trend)

Tactical Tilting

- Cycle, Valuation and Sentiment Framework

-0.3 years duration
+0.5 years std. spread duration*
+ tactical rates trades
+ tactical FX trades

Source: Russell Investments. For illustrative purposes only. As at 31 March 2020. Standardised spread duration is the equivalent spread duration in US IG corporates.

Thank you.

Any questions?

Important information

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