

UNDERSTANDING WHERE THE RISKS AND RETURNS ARE COMING FROM IN YOUR SHORT-TERM BOND STRATEGY



DAVID NAGLE, CFA
HEAD OF MULTI STRATEGY FIXED INCOME

Barings' Active Short Duration Strategy: A Tried, Tested and Transparent Approach

- Rules-based approach to rates, tested over 25 years
- Prudent exposure to below investment grade holdings
- Broad diversification across asset classes to generate risk-controlled alpha
- Target duration of three months to three years, depending on the slope of the U.S. Treasury yield curve

Short-term bond strategies have been consistently popular among investors seeking to protect their capital while also generating a return. These strategies are generally considered lower risk on the spectrum of potential investments, and investors may choose to invest in short-term bond strategies for a number of reasons, including:

- The potential for enhanced cash and higher total returns versus money market funds
- The potential for lower volatility versus equities or other higher-risk markets

What some investors may not realize is that within this space, the risk/return profile of short-term bond strategies can vary quite dramatically. One firm's strategy may be made up of short-term U.S. Treasuries, for instance, while another's may comprise a combination of longer-term corporate bonds and derivatives—although both are considered short-term strategies, the two have very different risk/return profiles. Given the potential for variation within the short-term bond universe, it is crucial that investors look closely at the makeup of a portfolio before making an investment and ask themselves: Where is the risk (and return) coming from?

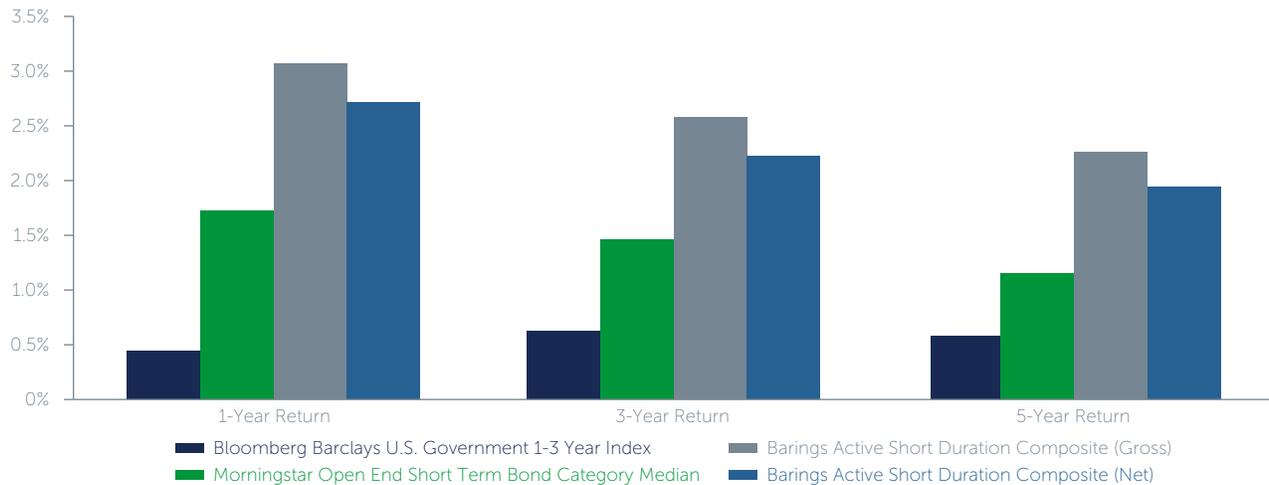
Two Ends of the Spectrum: Benchmark Huggers vs. the Wild West

From a risk/return perspective, many short-term bond funds fall into one of two categories relative to the index. As follows, the degree to which these funds deviate or tilt from the benchmark becomes the primary driver of performance.

On the one hand, there are low active share funds, or funds that closely resemble the relevant benchmark from both a credit and duration standpoint. These funds, because they don't stray from the index, do not tend to generate the excess returns investors would typically associate with or expect from actively managed strategies.

On the opposite end of the spectrum are funds that typically look nothing like the relevant benchmark, aiming to outperform by taking on interest rate risk, credit risk or some combination of both. Often, these funds—while maintaining an overall investment grade rating—have a meaningful percentage of their portfolios in lower quality/higher yielding investments, and as such tend to outperform during periods of spread tightening. This has been the case over the last year or so, during which spreads have tightened significantly and are now near post-recession tights with little room for further compression. When spreads widen, these strategies can experience greater volatility than your typical investment grade strategy—more akin to equity or high yield. This volatility may come as a surprise to investors who view their short-term bond strategy as a volatility buffer. One example of this was September 2011, when Standard & Poor's downgraded U.S. debt. Following the downgrade, many short-term bond funds experienced losses due to their outsized allocations to below investment grade names. The 2015/2016 energy weakness had a similar effect.

FIGURE 1: BARINGS' ACTIVE SHORT DURATION STRATEGY: ATTRACTIVE RETURNS OVER 1, 3, 5-YEAR PERIODS



SOURCE: BLOOMBERG/BARCLAYS AND MORNINGSTAR. AS OF DECEMBER 31, 2017. PLEASE SEE GIPS DISCLOSURE AT THE END FOR MORE INFORMATION. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

Other funds also aim to outperform by making calls or bets on the direction of interest rates, or anticipating what central banks are going to do and how the short end of the curve is going to react. When their calls are correct over a period of time, these strategies tend to gather a lot of assets. The downside, of course, is that it can be difficult to make these calls consistently, meaning investors are taking a leap of faith that their manager can continue making the correct call on rates.

The Best of Both Worlds

Unlike many comparable strategies, Barings' Active Short Duration strategy does not model duration or sector exposure after the benchmark. From an interest rate risk standpoint, while many funds in this universe are characterized by their static exposure, Barings' Active Short Duration strategy takes a dynamic, rules-based approach to duration management that has been tested throughout our 25 years in the market. As opposed to a subjective approach, the target portfolio duration of our Active Short Duration strategy is determined using the slope of the U.S. Treasury yield curve—duration increases to a maximum of three years as the yield curve steepens and decreases to a minimum of three months as it flattens or inverts.

From a credit risk standpoint, our Active Short Duration strategy takes a deliberate and considered approach to assuming risk. Our strategy includes allocations to individual credits and sectors that we believe will outperform based on the bottom-up analysis conducted by our large team of analysts across sectors including investment grade

corporates, securitized products (commercial mortgage backed securities, residential mortgage backed securities, asset backed securities), U.S. Treasuries, high yield, CLOs and emerging markets debt. We believe the credit-centric nature of our strategy can lead to outperformance, particularly during periods of market stress when overall spreads tend to widen.

Over time, our approach to actively managing credit and interest rate risk has resulted in returns that we believe fairly compensate investors for the level of risk they are taking.

The Barings Team

At Barings, we build portfolios from a bottom-up perspective, conducting rigorous credit analysis on each of the names in which we invest. We have deep research teams covering a range of asset classes and sectors, and our meaningful participation in these markets enables us to assess risk/reward in real-time and make opportunistic portfolio shifts to the potential benefit of our clients. Within our Active Short Duration strategy, the firm-wide emphasis on bottom-up analysis is evident in the way we introduce credit risk, not only allowing us to identify attractive credits but also helping us uncover downgrade and upgrade candidates early in the process. Whether we're looking at investment grade corporate credit, securitized products, emerging markets, CLOs or other parts of the fixed income universe, our deep research teams combined with our dedicated Active Short Duration portfolio team give us the ability to intelligently assess credit risk and thoughtfully incorporate it in our portfolios if we believe investors are being adequately compensated.

Barings Active Short Duration Composite

Reporting Currency: USD
Schedule of Performance Results

Date	Composite Annual Gross Return	Composite Annual Net Return	Barclays Capital Gov't 1-3 Yr Index Annual Returns	Asset-Weighted Dispersion	Composite Standard Deviation	Benchmark Standard Deviation	Total Assets (millions)	Total Firm Assets (millions)	Percentage of Firm Assets	# of Portfolios at End of Period
12/31/17	3.07%	2.71%	0.45%	NM	0.99%	0.75%	1,354	284,789	0.5%	<=5
12/31/16	3.36%	3.00%	0.87%	NM	1.07%	0.76%	1,110	178,724	0.6%	<=5
12/31/15	1.31%	0.96%	0.57%	NM	0.98%	0.57%	1,217	163,934	0.7%	6
12/31/14	1.98%	1.73%	0.64%	NM	0.72%	0.43%	1,167	157,257	0.7%	<=5
12/31/13	1.60%	1.34%	0.37%	NM	0.86%	0.49%	1,651	142,832	1.2%	<=5
12/31/12	3.60%	3.34%	0.51%	NM	1.28%	0.71%	1,164	116,633	1.0%	<=5
12/31/11	3.98%	3.72%	1.56%	NM	2.20%	0.95%	827	100,213	0.8%	<=5
12/31/10	6.11%	6.03%	2.40%	NM	3.19%	1.67%	685	95,808	0.7%	<=5
12/31/09	12.77%	12.68%	1.41%	NM	3.08%	1.80%	389	108,303	0.4%	<=5
12/31/08	0.37%	0.29%	6.66%	NM	2.43%	1.62%	391	99,036	0.4%	<=5

Benchmark returns © Copyright Barclays Capital Incorporated, 2017—all rights reserved.

NM The asset-weighted dispersion of five or fewer portfolios for the entire year is not meaningful. Please note that although 2015 ended the year with 6 portfolios, they were not all present for the entire year.

<=5 Five or fewer portfolios.

COMPLIANCE STATEMENT:

Barings, fka Babson Capital Management LLC, claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Barings has been independently verified for the periods 1993-2016 as Babson Capital Management LLC. See firm definition for further information.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Active Short Duration composite has been examined for the periods 2010-2016. The verification and performance examination reports are available upon request.

DEFINITION OF THE FIRM:

Barings, "Firm", provides investment management and advisory services to both institutional and individual clients. For purposes of compliance with the Global Investment Performance Standards (GIPS®), the Firm defines itself as consisting of the portfolios that it manages directly. In 2017, the previous subsidiaries of Babson Capital Management, "Babson", including Babson, were consolidated under the Barings name for GIPS purposes. Those entities included Babson Capital Management LLC, Cornerstone Real Estate Advisers LLC, Barings Asset Management Limited, and Wood Creek Capital Management LLC. In 2017, the firm assets represent the consolidated entity. A list of the Firm's composite descriptions is available upon request.

POLICIES:

The Firm's policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

COMPOSITE DESCRIPTION:

Portfolios in the composite seek to achieve a high total rate of return primarily from current income and to minimize fluctuations in capital values by investing primarily in diversified portfolios of short-term investment grade fixed income securities. By utilizing a yield preference approach, the duration is managed to a target (intended to be three years or less) that depends on the shape of the yield curve. Duration may be increased when longer-term investments are believed to offer sufficiently higher yields. Conversely, the duration may be decreased when short-term investments are believed to offer more attractive yields than longer-term investments, but with less risk. Portfolio duration changes will be made primarily by reinvesting cash flows and by selective trading. Additional value is added through sector rotation and issuer selection. Portfolios in the composite may invest up to 10% of total assets in below investment grade debt securities rated Ba3/BB- or higher. Derivative use within the composite membership incorporates certain options, futures contracts, options on futures contracts, forward contracts, swaps, caps, floors, collars, structured notes, indexed securities, options on indexed securities and other derivative instruments to modify risk exposures, such as Duration, Sector & issuer spread, Term structure,

and Volatility. Derivative activity within the composite is not viewed as material. The minimum portfolio value requirement for inclusion in the composite is USD \$15,000,000. The composite was created in June 2000.

BENCHMARK:

The Barclays Capital Government Index: 1-3 Years, "Index" has been selected as the benchmark for the composite. The Index includes securities in the U.S. Government Index that have between one and three years until maturity. In 2008, Barclays Capital Inc. acquired portions of Lehman Brothers businesses and re-branded its unified family of indices under the "Barclays Capital Indices" name.

FEES:

Returns are presented gross of management fees, custodial fees, and withholding taxes but net of all trading expenses. Net of fee performance results are calculated by deducting from the gross monthly return using the highest fee charged for a member portfolio on an annual basis dedicated to this strategy during the periods presented. Applicable Fees for 2006-2010: 8bps, 2011-2014: 25bps, and 2015 forward: 35bps. Actual fees may depend on, among other things, the applicable fee schedule and portfolio size.

SIGNIFICANT CASH FLOW:

Any portfolios determined to exceed the Significant Cash Flow Percentage, "SCFP", within a month, will be removed from the composite assignment for a period of at least one month and up to three months, depending on the timing of the client directed cash flow and/or the investment strategy. The SCFP for this composite is 10%. Additional information regarding the treatment of significant cash flows is available upon request.

PERFORMANCE RESULTS:

Results are calculated using a time-weighted total-rate-of-return formula and are expressed in U.S. dollars. The composite is asset-weighted; individual portfolios are valued daily on a trade-date basis and include accrued income. The composite and benchmark results assume the reinvestment of distributions. Performance results include all portfolios under the Firm's management that meet the Composite Definition. A portfolio is included in the composite when it is deemed that the investments made by the investment advisor fully reflect the intended investment strategy. Past performance is not a guarantee of future performance.

ASSETS, COMPOSITE DISPERSION, EX-POST STANDARD DEVIATION:

The asset base used to calculate the composite's percentage of Firm assets includes both discretionary and non-discretionary portfolios managed by the Firm, and also includes non-fee paying portfolios. The asset-weighted dispersion calculation measures the deviation of individual portfolio returns around the aggregate composite return. Only portfolios that have been managed for a full annual period have been included in the dispersion calculation. No Dispersion is reported for periods with five or fewer portfolios for the entire year (shown as NM). The three-year annualized ex-post standard deviation of the composite and benchmark are displayed above.

Any forecasts in this document are based upon Barings opinion of the market at the date of preparation and are subject to change without notice, dependent upon many factors. Any prediction, projection or forecast is not necessarily indicative of the future or likely performance. Investment involves risk. The value of any investments and any income generated may go down as well as up and is not guaranteed. Past performance is no indication of current or future performance. **PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.** Any investment results, portfolio compositions and or examples set forth in this document are provided for illustrative purposes only and are not indicative of any future investment results, future portfolio composition or investments. The composition, size of, and risks associated with an investment may differ substantially from any examples set forth in this document. No representation is made that an investment will be profitable or will not incur losses. Where appropriate, changes in the currency exchange rates may affect the value of investments. Prospective investors should read the offering documents for the details and specific risk factors of any Fund discussed in this document.

IMPORTANT INFORMATION

For Professional Investors / Institutional Investors only. This document should not be distributed to or relied on by Retail / Individual Investors.

Barings LLC, Barings Securities LLC, Barings (U.K.) Limited, Barings Global Advisers Limited, Barings Australia Pty Ltd, Barings Japan Limited, Barings Real Estate Advisers Europe Finance LLP, BREAE AIFM LLP, Baring Asset Management Limited, Baring International Investment Limited, Baring Fund Managers Limited, Baring International Fund Managers (Ireland) Limited, Baring Asset Management (Asia) Limited, Baring SICE (Taiwan) Limited, Baring Asset Management Switzerland Sarl, and Baring Asset Management Korea Limited each are affiliated financial service companies owned by Barings LLC (each, individually, an "Affiliate"), together known as "Barings." Some Affiliates may act as an introducer or distributor of the products and services of some others and may be paid a fee for doing so.

NO OFFER:

The document is for informational purposes only and is not an offer or solicitation for the purchase or sale of any financial instrument or service in any jurisdiction. The material herein was prepared without any consideration of the investment objectives, financial situation or particular needs of anyone who may receive it. This document is not, and must not be treated as, investment advice, an investment recommendation, investment research, or a recommendation about the suitability or appropriateness of any security, commodity, investment, or particular investment strategy, and must not be construed as a projections or predictions.

In making an investment decision, prospective investors must rely on their own examination of the merits and risks involved and before making any investment decision, it is recommended that prospective investors seek independent investment, legal, tax, accounting or other professional advice as appropriate.

Unless otherwise mentioned, the views contained in this document are those of Barings. These views are made in good faith in relation to the facts known at the time of preparation and are subject to change without notice. Individual portfolio management teams may hold different views than the views expressed herein and may make different investment decisions for different clients. Parts of this document may be based on information received from sources we believe to be reliable. Although every effort is taken to ensure that the information contained in this document is accurate, Barings makes no representation or warranty, express or implied, regarding the accuracy, completeness or adequacy of the information.

These materials are being provided on the express basis that they and any related communications (whether written or oral) will not cause Barings to become an investment advice fiduciary under ERISA or the Internal Revenue Code with respect to any retirement plan, IRA investor, individual retirement account or individual retirement annuity as the recipients are fully aware that Barings (i) is not undertaking to provide impartial investment advice, make a recommendation regarding the acquisition, holding or disposal of an investment, act as an impartial adviser, or give advice in a fiduciary capacity, and (ii) has a financial interest in the offering and sale of one or more products and services, which may depend on a number of factors relating to Barings' business objectives, and which has been disclosed to the recipient.

Nothing set forth herein or any information conveyed (in writing or orally) in connection with these materials is intended to constitute a recommendation that any person take or refrain from taking any course of action within the meaning of U.S. Department of Labor Regulation §2510.3-21(b) (1), including without limitation buying, selling or continuing to hold any security or other investment. You are advised to contact your own financial advisor or other fiduciary unrelated to Barings about whether any given course of action may be appropriate for your circumstances. The information provided herein is intended to be used solely by the recipient in considering the products or services described herein and may not be used for any other reason, personal or otherwise.

OTHER RESTRICTIONS:

The distribution of this document is restricted by law. No action has been or will be taken by Barings to permit the possession or distribution of the document in any jurisdiction, where action for that purpose may be required. Accordingly, the document may not be used in any jurisdiction except under circumstances that will result in compliance with all applicable laws and regulations.

Any service, security, investment or product outlined in this document may not be suitable for a prospective investor or available in their jurisdiction.

The information with respect to UCITS Funds is not intended for U.S. Persons, as defined in Regulation S under the U.S. Securities Act of 1933, or persons in any other jurisdictions where such use or distribution would be contrary to law or local regulation.

INFORMATION:

Barings is the brand name for the worldwide asset management or associated businesses of Barings. This document is issued by one or more of the following entities:

Barings LLC, which is a registered investment adviser with the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940, as amended (Barings LLC also relies on section 8.26 of NI 31-103 (international adviser exemption) and has filed the Form 31-103F2 in Ontario, Quebec, British Columbia, Alberta, Nova Scotia, Manitoba, New Brunswick, Newfoundland and Labrador, Prince Edward Island and Saskatchewan);

Barings Securities LLC, which is a registered limited purpose broker-dealer with the Financial Industry Regulatory Authority (Baring Securities LLC also relies on section 8.18 of NI 31-103 (international dealer exemption) and has filed the Form 31-103F2 in Ontario, Quebec, British Columbia, Alberta, Nova Scotia, Manitoba, New Brunswick, Newfoundland and Labrador, Prince Edward Island and Saskatchewan);

Barings (U.K.) Limited, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 194662) and is a Company registered in England and Wales (No. 03005774) whose registered address is 61 Aldwych, London, WC2B 4AE; Barings Global Advisers Limited, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 552931) and is a Company registered in England and Wales (No. 07622519) whose registered address is 61 Aldwych, London, WC2B 4AE and is a registered investment adviser with the SEC; Baring Asset Management Limited, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 170601) and is a Company registered in England and Wales (No. 02915887) whose registered address is 155 Bishopsgate, London EC2M 3XY; Baring International Investment Limited, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 122628), and is a Company registered in England and Wales (No. 01426546) whose registered address is 155 Bishopsgate, London EC2M 3XY, is a registered investment adviser with the SEC (Baring International Investment Limited also relies on section 8.26 of NI 31-103 (international adviser exemption) and has filed the Form 31-103F2 in Quebec and Manitoba);

Barings Real Estate Advisers Europe Finance LLP, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 401543); or

BREAE AIFM LLP, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 709904);

Baring Fund Managers Limited, which is authorized as a manager of collective investment schemes with the Financial Conduct Authority in the United Kingdom and is authorized as an Alternative Investment Fund Manager in several European Union jurisdictions under the Alternative Investment Fund Managers Directive (AIFMD) passport regime;

Baring International Fund Managers (Ireland) Limited, which is authorized as an Alternative Investment Fund Manager in several European Union jurisdictions under the Alternative Investment Fund Managers Directive (AIFMD) passport regime and, since April 28, 2006, as a UCITS management company with the Central Bank of Ireland;

Baring Asset Management Switzerland Sarl, which is authorized by the Switzerland Financial Market Supervisory Authority to offer and/or distribute collective capital investments;

Barings Australia Pty Ltd (ACN 140 045 656), which is authorized to offer financial services in Australia under its Australian Financial Services License (No: 342787) issued by the Australian Securities and Investments Commission;

Baring Asset Management (Asia) Limited, which is licensed by the Securities and Futures Commission of Hong Kong to carry on regulated activities Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts) and Type 9 (asset management) in Hong Kong in accordance with the requirements set out in the Securities and Futures Ordinance (Cap 571);

Barings Japan Limited, which is registered as a Financial Business Operator (Registration No. 396-KLFB) for Type II Financial Instruments Business, Investment Advisory and Agency Business, and Investment Management Business with the Financial Services Agency in Japan under the Financial Instruments and Exchange Act (Act No. 25 of 1948);

Baring SICE (Taiwan) Limited, an independently operated business (Business license number: 2008 FSC- SICE- Xin- 030; Address: 21 F, No. 333, Sec. 1 Keelung Road, Taipei 11012; Taiwan Contact telephone number: 0800 062 068); or

Baring Asset Management Korea Limited, which is authorized by the Korean Financial Services Commission to engage in collective investment business and is registered with the Korean Financial Services Commission to engage in privately placed collective investment business for professional investors, discretionary investment business and advisory business.

Copyright

Copyright in this document is owned by Barings. Information in this document may be used for your own personal use, but may not be altered, reproduced or distributed without Barings' consent.