# Melville Douglas Income Fund Ltd Income Class

Minimum Disclosure Document as at 30 June 2016

## Quarterly Commentary

Both in the UK and internationally, the unexpected win for the 'leave' camp in the late June EU Referendum provoked wide scale volatility in bond markets. The initial knee-jerk reaction on 24 June was all the more violent as in the days running up to the final vote, and indeed even at the eleventh hour, markets were increasingly convinced that 'remain' would win the day. UK, US and German government bond yields have fallen sharply lower across all maturities and by the following Monday, a further $380 billion of sovereign bonds had moved into negative territory taking the global tally to approximately $9 trillion.

In the US, the probability of another interest rate hike before year end has also reduced dramatically as the 'risk-off' tone permeates throughout global markets. Much obviously depends on upcoming data releases, which if firm enough, may convince the Federal Open Markets Committee (FOMC) to press on with gradual increases in the quarters ahead. Brexit aside, the US economy continues to 'muddle through', supported by strong employment growth and a resilient housing market. Indications are that growth in the second quarter will recover decently from the weakness exhibited in the first quarter, a common theme for the past few years.

Whilst on a trade-weighted basis the US Dollar has been broadly flat in the quarter, pleasingly it has accrued solid gains against Sterling and the Euro, benefitting our strategy. Given the negative Brexit implications for both the UK and Eurozone, it is easy to understand the US Dollar's recent rally against both currencies and further, albeit more moderate, strength against the pair over the medium term appears to be the most likely outcome. Whilst the outlook for higher rates in the US has undoubtedly been tempered by Brexit, the FOMC remain in tightening mode versus a very clear easing bias for the ECB and perhaps now, the Bank of England's MPC. In a world of ever decreasing, and often negative rates, investor's efforts to search out yield without undue risk are leaving fewer and fewer options. The Fund remains overweight US Dollar's with a 100% allocation.

We have long been of the opinion that yields would normalise, or rise, from near historically low levels and as such, have maintained within the Fund a defensive capital preservation strategy with a short duration bias. Indeed, this is, and has been, an almost universally held view with many analysts and economists in fact forecasting yields to rise much higher than our own projections over the medium term. Recent moves in yields have been violently to the downside thanks to the 'Brexit-induced' uncertainty and as such, our fixed income strategies have markedly outperformed comparable cash returns in the first half of the year. We are frustrated however that we have not managed to capture most of the upside in the recent rally in global bonds. Our core thesis remains, in that we aim to deliver consistent long term returns without exposing the Fund to excessive risk, which can often lead to unwanted periods of drawdown.