

# BBH Luxembourg Funds - BBH Income Fund

Quarterly Fund Update / 3Q 2023

For Professional / Non-Retail Use Only  
in Germany, Luxembourg and the UK

## 3Q Highlights

- U.S. Treasury rates rose during the third quarter as the U.S. economy appeared to be on strong footing, with investors capitulating to the view that the Federal Reserve will keep rates “higher for longer.”
- Sector allocation influenced performance favorably during the quarter, and security selection results further enhanced results.
- Despite waning opportunities in the credit markets, we identified numerous new opportunities for the Fund during the quarter.

## Performance

Past performance does not predict future results

| Annual Returns                    |         |        |      |      |      |      |      |      |      |      |
|-----------------------------------|---------|--------|------|------|------|------|------|------|------|------|
|                                   | 2022    | 2021   | 2020 | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| Class A                           | -13.28% | 0.13%  | N/A  | N/A  | N/A  | N/A  | N/A  | N/A  | N/A  | N/A  |
| Bloomberg US Aggregate Bond Index | -13.01% | -1.54% | N/A  | N/A  | N/A  | N/A  | N/A  | N/A  | N/A  | N/A  |

## As of 30 September 2023

| Fund/Benchmark                    | Total Returns |        | Average Annual Total Returns |       |       |        |                 |
|-----------------------------------|---------------|--------|------------------------------|-------|-------|--------|-----------------|
|                                   | 3 Mo          | YTD    | 1 Yr.                        | 3 Yr. | 5 Yr. | 10 Yr. | Since Inception |
| Class A                           | -2.53%        | 0.13%  | -2.48%                       | N/A   | N/A   | N/A    | -4.43%          |
| Bloomberg US Aggregate Bond Index | -3.23%        | -1.21% | -0.64%                       | N/A   | N/A   | N/A    | -5.23%          |

Class A Ongoing Charges: 0.55%

Inception date: 11/02/2020

Returns of less than one year are not annualized

The past performance excludes the entry and exit charges. The ongoing charges figure shown is an estimate and excludes portfolio transaction costs. This figure may vary from year to year. The entry charge is 3% of the initial price of the subscription price. The Fund shares redeemed within 30 days of purchase may be subject to an exit charge of 1%. The entry and exit charges shown are maximum figures. In some cases you may pay less.

Performance has been calculated in USD. Performance can be increased or reduced as a result of currency fluctuations.

Sources: Bloomberg and BBH & Co.

## Market Environment

U.S. Treasury rates rose during the third quarter. The U.S. economy appears to be on strong footing, and investors are capitulating to the view that the Federal Reserve (Fed) will need rates to be “higher for longer.” The Fed hiked the target range of the federal funds rate by 0.25% to 5.25%-5.50% at its July meeting. The Fed’s next announcement is scheduled for November 1st. In addition, the Fed continued its campaign of shrinking its portfolio of assets acquired through open market operations by a maximum of \$95 billion per month.

On a duration-adjusted basis, nearly every credit index earned positive excess returns during the quarter, though agency mortgage-backed securities (MBS) were a noteworthy underperformer (see Exhibit I). Indexes tied to floating rate investments and with shorter durations experienced positive total returns despite the rise in rates. Long maturity corporate bonds (those with 10+ years until maturity) also had strong excess returns during the quarter.

Year-to-date, all credit indexes had positive excess returns except for agency MBS. Non-agency commercial mortgage-backed securities (CMBS) slightly outperformed comparable duration Treasuries despite negative headlines regarding commercial real estate (CRE). Indexes of investment-grade corpo-

## Exhibit I: Fixed Income Indexes Returns

| Index  | Duration (Years) | Total Return (%) |              | Excess Return (%) |             |
|--|------------------|------------------|--------------|-------------------|-------------|
|  |                  | QTD              | YTD          | QTD               | YTD         |
| Morningstar LSTA Leveraged Loan Index <sup>1</sup> | 0.3              | 3.46             | 10.19        | 2.13              | 6.47        |
| Palmer Square CLO Debt Index <sup>1</sup>          | 0.3              | 5.30             | 12.83        | 3.97              | 9.11        |
| Bloomberg 2 Year U.S. Treasury Bellwether Index    | 1.8              | 0.57             | 1.14         | —                 | —           |
| Bloomberg ABS ex Stranded Cost Utilities Index     | 1.9              | 0.84             | 2.35         | 0.19              | 0.60        |
| Bloomberg U.S. Corporate High Yield Index          | 3.5              | 0.46             | 5.86         | 1.02              | 5.16        |
| Bloomberg Non-Agency CMBS Index                    | 3.8              | -0.23            | 0.23         | 0.66              | 0.07        |
| ICE BofA AA-BBB US Misc. ABS Index <sup>2</sup>    | 3.9              | 0.88             | 4.81         | 2.09              | 5.36        |
| Bloomberg Intermediate Corporate Index             | 4.0              | -0.96            | 1.35         | 0.12              | 1.36        |
| Bloomberg U.S. TIPS Index                          | 5.0              | -2.60            | -0.78        | —                 | —           |
| Bloomberg U.S. Treasury Index                      | 5.9              | -3.06            | -1.52        | —                 | —           |
| Bloomberg EM USD Aggregate Index                   | 5.9              | -2.31            | 0.91         | 0.80              | 2.59        |
| <b>Bloomberg Aggregate Index</b>                   | 6.1              | -3.23            | <b>-1.21</b> | <b>0.00</b>       | <b>0.50</b> |
| Bloomberg MBS Index                                | 6.4              | -4.05            | -2.26        | -0.85             | -0.58       |
| Bloomberg U.S. Corporate Index                     | 6.8              | -3.09            | 0.02         | 0.84              | 2.37        |
| Bloomberg 10 Year U.S. Treasury Bellwether Index   | 8.0              | -5.12            | -3.43        | —                 | —           |
| Bloomberg Taxable Municipal Index                  | 9.3              | -4.90            | -0.12        | 1.45              | 4.27        |
| Bloomberg Long Corporate Index                     | 12.5             | -7.23            | -2.71        | 2.18              | 4.22        |

### Past performance is no guarantee of future results

Unless otherwise noted Excess Returns is the returns in excess of duration matched Treasuries

<sup>1</sup> Excess return computed by BBH as total return less the return of the Bloomberg 3 Month T-Bill Bellwether Index, a proxy for the duration profile of floating-rate leveraged loans and the CLO Index

<sup>2</sup> Excess return computed by BBH as total return less the return of the Bloomberg 5 Year Treasury Bellwether Index, a proxy for the duration profile of the JPM Other ABS Index

Data reported as of 30 September 2023

Sources: Morningstar, JPM, Bloomberg, and BBH Analysis

This is a marketing communication. Please refer to the prospectus of the fund and to the KIID/KID before making any final investment decisions.

rate bonds, senior bank loans, high yield corporate bonds, nontraditional asset-backed securities (ABS), and collateralized loan obligation (CLO) debt posted strong excess returns.

## Valuations

The strong recent performance of credit instruments has caused valuations to weaken. According to our valuation framework,<sup>1</sup> the number of investment-grade corporate bonds that screened as a “buy” decreased to 32% and the number of high yield corporate bonds screened as a “buy” decreased to 33%. Within the investment-grade corporate bond market, we find most opportunities in short and intermediate duration segments of single-A and triple-B rated bonds, as well as nontraditional issuances that do not meet index inclusion criteria but offer compelling valuation while meeting our credit criteria. In the high yield corporate bond market, there are many opportunities among smaller issuers in the double-B and single-B rated markets. However, our valuation framework identifies plenty of “hold” and “sell” candidates in those ratings categories, so there are numerous value traps and valuation-sensitive selection remains imperative.

In the structured credit markets, we are finding an abundance of attractively valued opportunities as we observe a continuing disconnect between wider credit spread levels and solid credit performance (see Exhibit II). Issuances of select non-traditional ABS, Single Asset, Single Borrower (SASB) CMBS, and CLO debt have come with attractive compensation and strong durability and structural protections. Opportunities are emerging in parts of the agency MBS market as valuations improve, and we are prepared to add positions.

Non-agency residential mortgage-backed securities (RMBS) continue to suffer from lower durability, thin credit enhancement, and prepayment risk. We continue to avoid emerging markets credits due to concerns regarding creditor rights in most countries.

### Exhibit II: Outlook by Sector

| Sector                           | Outlook   | Positioning   |
|----------------------------------|---|---|
| <b>Reserves</b>                  |   |   |
| U.S. Treasuries/Futures/Reserves | Hold when attractive credits unavailable  | Held to balance yield curve and duration exposures  |
| Government-Related               | Unattractive valuations; better opportunities elsewhere                                   | No positions in portfolios  |
| Municipal                        | Valuations of select municipals are attractive for inclusion in taxable portfolios        | Holdings include transportation revenue bonds   |
| <b>Structured Credit</b>         |   |   |
| U.S. MBS                         | Valuations improving in parts of the market   | No positions in portfolios; prepared to add opportunistically   |
| RMBS                             | Continued credit and valuation concerns   | No positions in portfolios  |
| CMBS                             | Traditional conduits unattractive, select SASB issuances attractive                       | Hold positions in fixed- and floating-rate SASB CMBS deals with strong property-level transparency  |
| ABS                              | Traditional segments unattractive, select nontraditional segments attractive              | Hold positions in 20 nontraditional segments that offer attractive yields and demonstrable durability   |
| <b>Corporate Credit</b>          |   |   |
| IG Corporate Bonds               | Find value in short and intermediate index-eligible bonds and select nontraditional bonds | Holdings include intermediate maturity credits issued by banks, business development companies, property and casualty insurers, and life insurers |
| HY Corporate Bonds               | Roughly one-third of universe screens as “buy” with most being bonds of smaller issuers   | Holdings are diversified and include credits issued by midstream energy, electric utilities, and specialized REITs                                |
| <b>Other Credit</b>              |   |   |
| Emerging Markets                 | Concerns remain about creditor rights in most emerging market countries                   | No positions in portfolios  |

As of 30 September 2023

Portfolio holdings and characteristics are subject to change.

MBS = Mortgage-Backed Securities; RMBS = Residential Mortgage-Backed Securities; CMBS = Commercial Mortgage-Backed Securities; ABS = Asset-Backed Securities; SASB = Single Asset, Single Borrower; IG = Investment Grade; HY = High Yield; REIT = Real Estate Investment Trust

Source: BBH Analysis

<sup>1</sup> Our valuation framework is a purely quantitative screen for bonds that may offer excess return potential, primarily from mean reversion in spreads. When the potential excess return is above a specific hurdle rate, we label them “Buys” (others are “Holds” or “Sells”). These ratings are category names, not recommendations, as the valuation framework includes no credit research, a vital second step.

## Performance

Sector allocation influenced performance favorably during the quarter. The Fund benefitted from its emphases on investment grade corporate bonds and its avoidance of agency MBS.

Favorable selection results also impacted the Fund's relative performance. Positions in investment grade corporate bonds issued by life insurers, property and casualty (P&C) insurers, business development companies (BDCs), and banks had notable contributions. Holdings of high yield corporate bonds issued by P&C insurers and specialty real estate investment trusts (REITs) enhanced relative results further.

The Fund's duration and yield curve composition had a positive but smaller impact on relative results.

## Transaction Summary

We purchased bonds from a variety of corporate industries during the quarter. Purchases included corporate bonds issued by electric utilities, banks, life insurers, REITs, and construction machinery companies.

**NRG Energy Inc** is the third largest publicly traded merchant power generation company and the largest power marketer in the U.S. NRG's credit strengths include low leverage, significant liquidity, diverse exposure to different wholesale power markets, and a physical hedge against wholesale power dynamics through its retail power and gas marketing platform. We bought the new issue, 5 year, BBB- rated secured notes at a yield of 7.5% and a spread of 310 basis points<sup>2</sup> over Treasuries.

**Corebridge Financial Inc** is a life insurance company that was spun off from AIG, and the company benefits from significant scale and diversification. Their credit strength is derived from an excellent balance sheet, brand recognition, diverse product mix, excellent liquidity, and strong underwriting. We bought the new issue, 5 year, A+ rated notes at a spread of 149 basis points over Treasuries.

**Vistra Corp** is the second largest publicly traded merchant power generation company in the U.S. The company benefits from diverse exposure to multiple unregulated power markets as well as a comprehensive commodities hedging platform that allows it to stabilize earnings and cash flows. Vistra's credit strength is derived from its low leveraged balance sheet, significant liquidity, and excellent commodity hedging platform. We bought their new issue, 10 year, BBB- rated notes at a yield of 7% and a spread of 270 basis points over Treasuries.

**Penske Truck Leasing Co.** provides full-service leasing and rental of trucks, tractors, and trailers, as well as contract maintenance and supply chain services. The company's mix of diverse and complementary services and market-leading positions lead to revenue visibility, consistent profit margins, and free cash flow<sup>3</sup> generation. We bought the new issue, 5 year, BBB+ rated notes at a spread of 185 basis points over Treasuries.

## Characteristics

At the end of the month, the Fund's duration was 0.9 years (see Exhibit IV). High yield investments represented 8.2% and were comprised primarily of credits rated double-B. Yield to maturity was 6.7% and remained elevated versus short-term bond market alternatives. The Fund's option-adjusted spread (OAS) was 142 basis points over Treasuries; for reference, the longer-duration Bloomberg U.S. Corporate Index's OAS was 121 basis points over Treasuries at month-end.

Exhibit III: Fund Attribution

|                        | Average Weight (%) |            |          | Contribution (Basis Points - Gross) |           |           |
|------------------------|--------------------|------------|----------|-------------------------------------|-----------|-----------|
|                        | Portfolio          | Benchmark  | Active   | Rates                               | Sector    | Selection |
| <b>Total Portfolio</b> | <b>100</b>         | <b>100</b> | <b>0</b> | <b>10</b>                           | <b>39</b> | <b>36</b> |
| US Treasury            | 18.9               | 41.1       | -22.2    | 0                                   | 0         | 0         |
| Cash and Reserves      | 1.1                | 0.0        | 1.1      | 0                                   | 0         | 0         |
| Government-Related     | 0.0                | 5.1        | -5.1     | -1                                  | 0         | 0         |
| Municipal              | 0.7                | 0.0        | 0.7      | 1                                   | -1        | -1        |
| US MBS                 | 0.0                | 26.8       | -26.8    | 23                                  | 0         | 0         |
| CMBS                   | 0.0                | 1.7        | -1.7     | -1                                  | 0         | 0         |
| ABS                    | 0.0                | 0.5        | -0.5     | 0                                   | 0         | 0         |
| IG Corporate Bonds     | 69.7               | 24.8       | 44.9     | 18                                  | 30        | 30        |
| HY Corporate Bonds     | 9.6                | 0.0        | 9.6      | 0                                   | 7         | 7         |

### Past performance is no guarantee future results

Contribution figures are presented gross of fees

Data reported quarterly from 30 June 2023 to 30 September 2023

Basis point or "bp" is 1/100th of a percent (0.01% or 0.0001)

MBS = Agency Residential Mortgage-Backed Securities; RMBS = Non-Agency Residential Mortgage-Backed Securities;

CMBS = Commercial Mortgage-Backed Securities; ABS = Asset-Backed Securities; IG = Investment Grade; HY = High Yield

Source: BBH Analysis

<sup>2</sup> Basis point (bps) is a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument.

<sup>3</sup> Free cash flow (FCF) is the cash a company generates after taking into consideration cash outflows that support its operations and maintain its capital assets.

**Exhibit IV: Fund Characteristics**

| Portfolio Characteristics    |           |           |        | Credit Rating (%) |           |           | Sector Allocation (%) |           |           |        |
|------------------------------|-----------|-----------|--------|-------------------|-----------|-----------|-----------------------|-----------|-----------|--------|
|                              | Portfolio | Benchmark | Active |                   | Portfolio | Benchmark |                       | Portfolio | Benchmark | Active |
| Effective Duration (Years)   | 0.85      | 1.75      | -0.90  | AAA/TSY/Cash      | 13.4      | 100.0     | U.S. Treasury         | 0.0       | 100.0     | -100.0 |
| Spread Duration (Years)      | 1.67      | 0.00      | 1.67   | AA                | 14.0      | 0.0       | Reserves              | 9.2       | 0.0       | 9.2    |
| Yield to Maturity (%)        | 6.72      | 5.14      | 1.58   | A                 | 31.2      | 0.0       | Government-Related    | 1.0       | 0.0       | 1.0    |
| Option-Adjusted Spread (bps) | 142       | 0         | 142    | BBB               | 33.3      | 0.0       | Municipal             | 2.0       | 0.0       | 2.0    |
|                              |           |           |        | BB                | 7.3       | 0.0       | MBS (Agency)          | 0.1       | 0.0       | 0.1    |
|                              |           |           |        | B                 | 0.9       | 0.0       | CMBS                  | 1.1       | 0.0       | 1.1    |
|                              |           |           |        | CCC & Below/NR    | 0.0       | 0.0       | ABS                   | 0.2       | 0.0       | 0.2    |
|                              |           |           |        |                   |           |           | IG Corporate Bonds    | 78.3      | 0.0       | 78.3   |
|                              |           |           |        |                   |           |           | HY Corporate Bonds    | 8.1       | 0.0       | 8.1    |

**Portfolio holdings and characteristics are subject to change.**

Bloomberg US 1-3 Year Treasury Bond Index

Data reported as of 30 September 2023

TSY = Treasury; MBS = Mortgage-Backed Securities; CMBS = Commercial Mortgage-Backed Securities; ABS = Asset-Backed; IG = Investment Grade; HY = High Yield

Source: BBH Analysis

**Conclusion**

Higher interest rates will ultimately bring higher returns for credit investors. We caution that a strong economy should not be the basis for investor credit decisions. Higher-for-longer interest rates will eventually weigh on many borrowers. Instead, we focus on durable credits<sup>4</sup> which is a hallmark of our process. Thank you for your continued trust, and we look forward to our conversations over the coming weeks.

Sincerely,



Andrew P. Hofer  
Fund Co-Manager




Neil Hohmann, PhD  
Fund Co-Manager




Paul Kunz, CFA  
Fund Co-Manager




Thomas Brennan, CFA  
Fixed Income Product Specialist



<sup>4</sup> Obligations such as bonds, notes, loans, leases, and other forms of indebtedness, except for cash and cash equivalents, issued by obligors other than the U.S. Government and its agencies, totaled at the level of the ultimate obligor or guarantor of the Obligation. Durable means the ability to withstand a wide variety of economic conditions.

Opinions, forecasts, and discussions about investment strategies represent the author's views as of the date of this commentary and are subject to change without notice. References to specific securities, asset classes, and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as recommendations.

Purchase and sale information provided should not be considered as a recommendation to purchase or sell a particular security and that there is no assurance, as of the date of publication, that the securities purchased remain in a fund's portfolio or that securities sold have not been repurchased. Nothing contained herein is intended as a recommendation to buy or sell any security, or to invest in any particular country, sector or asset class.

Traditional ABS include prime auto backed loans, credit cards and student loans (FFELP). Non-traditional ABS include ABS backed by other collateral types.

Holdings are subject to change. Totals may not sum due to rounding.

Credit Quality letter ratings are provided by Standard and Poor's, Moody's and Fitch and are presented as the higher of the three ratings. When a security is not rated by Standard & Poor's, Moody's or Fitch, the highest credit ratings from DBRS and Kroll may be used. Absent a rating from these agencies, we may display Private Credit Ratings, if permitted by the issuer, which could include ratings from Egan-Jones Ratings Co. Credit ratings reflect the credit quality of the underlying issues in the portfolio and not of the portfolio itself. Issues with credit ratings of BBB or better are considered to be investment grade, with adequate capacity to meet financial commitments. Issues with credit ratings below BBB are considered speculative in nature and are vulnerable to the possibility of issuer failure or business interruption.

Effective duration is a measure of the portfolio's return sensitivity to changes in interest rates. Weighted Average Life of securities excludes US Treasury futures positions.

Yield to Maturity is the rate of return the portfolio would achieve if all purchased bonds and derivatives were held to maturity, assuming all coupon and principal payments are received as scheduled and reinvested at the same yield to maturity. This figure is subject to change and is not meant to represent the yield earned by any particular security. Yield to Maturity is before fees and expenses.

Weighted Average Life of securities excludes US Treasury futures positions.

The Fund is actively managed. Under normal circumstances, the Fund is managed with the intention of maintaining an effective duration of between 80%-120% of the effective duration of Bloomberg US Aggregate Index.

Traditional ABS include prime auto backed loans, credit cards and student loans (FFELP). Non-traditional ABS include ABS backed by other collateral types

### Definitions

Bloomberg US Aggregate Bond Index is a market value-weighted index that tracks the daily price, coupon, pay-downs, and total return performance of fixed-rate, publicly placed, dollar-denominated, and non-convertible investment grade debt issues with at least \$300 million par amount outstanding and with at least one year to final maturity.

An index is not available for direct investment.

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### Risks

Investors in the Fund should be able to withstand short-term fluctuations in the fixed income markets in return for potentially higher returns over the long term. The value of portfolios changes every day and can be affected by changes in interest rates, general market conditions and other political, social and economic developments.

Investing in the bond market is subject to certain risks including market, interest-rate, issuer, credit, maturity, call and inflation risk; investments may be worth more or less than the original cost when redeemed. Bond prices are sensitive to changes in interest rates and a rise in interest rates can cause a decline in their prices.

Asset-Backed Securities ("ABS") are subject to risks due to defaults by the borrowers; failure of the issuer or servicer to perform; the variability in cash flows due to amortization or acceleration features; changes in interest rates which may influence the prepayments of the underlying securities; misrepresentation of asset quality, value or inadequate controls over disbursements and receipts; and the ABS being structured in ways that give certain investors less credit risk protection than others. SASB lacks the diversification of a transaction backed by multiple loans since performance is concentrated in one commercial property. SASBs may be less liquid in the secondary market than loans backed by multiple commercial properties.

The Fund also invests in derivative instruments, investments whose values depend on the performance of the underlying security, assets, interest rate, index or currency and entail potentially higher volatility and risk of loss compared to traditional stock or bond investments.

Non-U.S. investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards.

Illiquid investments subject the Fund to the risk that it may not be able to sell the investments when desired or at favorable prices.

There is no assurance the Fund will achieve its investment objectives.

**Complete information on the Fund's risks and expenses can be found in the prospectus.**

The decision to invest in the fund should take into account all the characteristics or objectives of the fund as described in its prospectus

### Other Important Disclosures

Brown Brothers Harriman & Co. ("BBH") is the promoter and principal distributor of the Funds. Brown Brothers Harriman Mutual Fund Advisory Department (a separately identifiable department of BBH) provides investment advice to the Funds. BBH Luxembourg Funds (the "Company") is a Luxembourg-registered Société d'Investissement à Capital Variable - undertaking for collective investment in transferrable securities (SICAV-UCITS) regulated by the Commission de Surveillance du Secteur Financier ("CSSF"), the Luxembourg financial services authority. The SICAV designated FundRock Management Company S.A. to serve as its designated management company in accordance with Chapter 15 of the Luxembourg Law of 17th December 2010; FundRock Management Company S.A. was incorporated on 10 November 2004 for an unlimited duration under the laws of Luxembourg and registered on the official list of Luxembourg management companies.

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The Company complies with the European Directive 2009/65/EC on undertaking for collective investment in transferable securities (UCITS), dated 13 July 2009, which established a set of common rules in order to permit the cross border marketing of collective investment schemes. Unauthorized distribution, reproduction or redistribution of this document without the prior written permission of the Company is prohibited. Potential investors in the Fund should not treat the contents of this document as advice relating to legal, taxation, investment or any other matters and are recommended to consult their own professional advisers concerning the acquisition, holding or disposal of shares of the Fund.

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**For Prospective Investors Domiciled in Germany:**

**The Fund is duly registered with the German Federal Financial Supervisory Authority, the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin). The representative agent of the Fund in Germany is Société Générale (Dejan Djurdjevi - Tel.: +49 (0) 69 7174 497).**

**For Prospective Investors Domiciled in Luxembourg:**

**The Company's address in Luxembourg is 6, route de Trève, L-2633 Senningerberg, Grand Duchy of Luxembourg (Tel.: +1-800-625-5759).**

**For Prospective Investors Domiciled in the UK:**

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**May Lose Money**

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