Melville Douglas Income Fund Ltd - USD Income Class

Minimum Disclosure Document as at 31 December 2016

Quarterly Commentary

In the second half of the year, a reversal of a multitude of factors have combined to upset the complacency that had deeply imbedded itself into fixed income markets. The first half of the year was dominated by subdued inflationary pressures, less than inspiring global economic data and the misplaced perception that central banks would be 'on hold' at worst and continue to dig even deeper into the ultra-easy monetary policy toolbox.

Around the middle of the year, the outlook for bonds began to dim initially with a growing chorus calling for some form of fiscal stimulus as it was becoming increasingly evident that lower, and in some cases more negative interest rates, were not having the desired or intended effect. At the same time, economic data began to quietly improve - Gross Domestic Product (GDP) in the US rose from a meagre 0.8% annualised pace in the first quarter to 3.5% in the third and inflation, which already had the feel good factor from a doubling in the oil price, jumped from 1% midway through the year to 1.7% in November.

Then, to add fuel to fire, the (almost) impossible happened with Trump winning the US Presidential Election. The immediate reaction in the bond markets was one of panic with yields falling but that lasted only moments as markets began to quickly re-price for the 'what if' scenario. That what if is Trump's stated massive reflationary push via personal and corporate tax cuts and a $1 trillion infrastructure spend, all designed to 'make America great again' or put another way, get growth to 4%.

The Federal Reserve hiked rates by 0.25% again in December and more importantly, are now pencilling in another three (maybe four) next year. Looking forward, we view further normalisation, or ongoing rises in yields, as a healthy and much needed event for the bond markets which will allow us to continue to add duration to the Fund as this process continues.

The US Dollar staged a massive recovery in the fourth quarter, rising approximately 8% on a trade-weighted basis thereby erasing all weakness seen earlier in the year. The rally was predominantly driven by the surge in US bond yields and we see this theme continuing over the short-term. The Fund remains 100% allocated to US Dollars.