

abr dn Absolute Return Global Bond Strategies Fund



31 May 2022

Market review

Despite intra-month volatility amid the persistence of key risk drivers in the form of the Russia-Ukraine conflict, monetary policy tightening and worries around Covid-19 restrictions in China, investors got some reprieve as markets ended May on a broadly modest positive note. Inflationary fears remained elevated amid higher-than-expected US Consumer Price Index (CPI) inflation and global supply chain worries, but investors' focus largely remained tilted towards economic growth risks. Major central banks maintained hawkish rhetoric on monetary policy with the Federal Reserve, Bank of England and Reserve Bank of New Zealand (RBNZ) all hiking interest rates during the month.

Fixed income markets were mixed. Yields declined in the US but rose in Europe, Japan and the UK as investors refocused on the risk of demand surprising on the downside and the monetary policy environment beyond the current interest rate hiking cycle. Within currency markets, the US dollar retreated from a 20-year peak against its major peers. Elsewhere, commodity markets continued their winning streak, delivering a gain (this time of 1.44%) for the sixth consecutive month, on the back of rising oil and wheat prices.

Portfolio review

The abr dn Absolute Return Global Bond Strategies Fund returned -1.02% (net of fees) during the month. The benchmark Bloomberg AusBond Bank Bill Index returned 0.03%.

The Fund positioning has been based on the expectation that as the cycle matures next year, economic growth will slow, with market fundamentals beginning to weaken in the second half of this year. As a result, we expect risk premia to rise across all markets and are therefore running a lower-than-average level of market exposure. In this environment, the portfolio continues to be defensive. We have reduced exposure to corporate bond markets while shifting the interest rate exposure to those sections of the market that we expect to perform well in an environment of tightening financial

conditions and slowing growth.

Overall, our interest rate risk-oriented strategies detracted from performance. Positive contribution from the recently introduced short Italian government bond position and the subsequent US versus Italian interest rates relative value strategy was offset by poor performance from our US interest rates exposure. Risk-facing corporate bond positions also detracted as exposures to asset-backed securities, short-dated emerging market corporate bonds and high yield bonds weighed on performance. This was partly mitigated by positive returns from our credit decompression strategy. Within currency exposures, our US dollar versus Chinese renminbi position delivered positive returns, although this was offset by performance drag from our favoured defensive foreign exchange strategy.

During May, we reduced corporate bond exposure while adding interest rate risk at the margin and enhancing the focus on relative value strategies. Specifically, we opened a short high yield credit position and hedged our Asia high yield strategy, effectively creating a cross market relative value pairing alongside some short exposure to the European high yield market. Similarly, we added outright exposure to the Australian interest rates market as well as an Australian versus US interest rates relative value strategy. This reflects our expectation that monetary policy tightening in Australia will be constrained by the significant amount of floating rate mortgages and excessive household debt to disposable income levels. Likewise, we opened a short Italian government bonds position but later converted this position to a relative value pairing alongside some exposure to the US interest rate market. This reflects our expectation that the high Eurozone inflation, exacerbated by the weak euro and ongoing Russia-Ukraine conflict, will provide the impetus for the European Central Bank to tighten monetary policy. Meanwhile, we opened a short Japanese government bonds position, underpinned by the expectation that the Bank of Japan will move away from its yield

Investment strategy

The Fund will invest in the Underlying Fund and may hold up to 5% of its assets in cash.

The Underlying Fund aims to deliver a return of SONIA plus 3% per annum, before charges, over rolling three-year periods.

The investment team who actively manage the Underlying Fund have a wide investment remit to help them try to achieve this aim. The team look to exploit market inefficiencies through active allocation to a diverse range of market positions.

The Underlying Fund utilises a combination of traditional assets (such as bonds, cash and money market instruments) and investment strategies based on advanced derivative techniques resulting in a highly diversified portfolio.

The Underlying Fund can take long and short positions in markets, securities and groups of securities through derivative contracts.

Investment objective

The primary investment objective of the Fund is to deliver a positive absolute return over the medium to long term in all market conditions.

The Underlying Fund is actively managed, with a wide investment remit to target a level of return over rolling three-year periods equivalent to cash* plus 3% per year, before charges. We would expect it to exhibit annualised volatility** of less than 5% in ordinary market conditions***.

*Cash returns are currently referenced to SONIA (which has been chosen as a proxy for the return on cash deposits), however the reference index may change over time. Performance of the Australian dollar hedged share class will instead be compared with the Bloomberg AusBond Bank Bill Index.** Measured over 3 years of monthly returns.*** The investment objective is expressed before the deduction of management fees, expense recoveries and taxation.

curve control policy as it seeks to stem rising inflation and support the weak yen. Furthermore, we closed the New Zealand interest rates position in light of the greater-than-expected inflationary pressures and hawkish tilt by the RBNZ. Elsewhere, we exited the US rates volatility and short US real yields strategies and reduced our allocations to contingent capital bonds and our US dollar versus Chinese renminbi pair.

Outlook

We have reduced our exposure to risk assets because of recent global developments and added slightly to defensive positions. We still believe that the second half of the year will see strong inflationary pressures, and a slight pickup in demand as the global recovery from its Covid-19 induced slumber continues. However, our expectation of the level of global growth has fallen. Our portfolio remains slightly risk-facing and continue to retain positions that will benefit from regional divergence.

Fund performance is available on the relevant factsheet.

The opinions expressed are those of abrdn as of the date of publication and are subject to change at any time due to changes in market or economic conditions.

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