

31 July 2022

Market review

July was a positive month for global markets, as risk assets rebounded somewhat. The move comes as investors see a less aggressive pace of monetary tightening from the US Federal Reserve (Fed) and possible early signs that inflation may be peaking. The Fed Chair Jerome Powell acknowledged softening economic changes but also reiterated that ensuring inflation is under control is the Fed's priority.

In Europe, the European Central Bank surprised investors with a 50 basis points (bps) hike in interest rates, which is higher than the expected 25bps, as inflationary pressures continue. A key worry in Europe has been the effect of the Ukraine conflict on natural gas and the maintenance of the Nord Stream 1 pipeline, with gas flow slowing to 20% of capacity during the month. European Union countries reached a deal on emergency gas cuts and plan to curb demand for the winter months.

Inflation expectations began to decline as a result of the pullback in commodity prices, as the prospect of slower growth affected oil, copper, wheat and iron prices.

The second-quarter earnings season began in July. While result surprises remain positive, they are well off levels seen in recent quarters. Forward guidance was more negative, with key themes being hiring slowdowns, banks increasing their credit-loss positions and weaker advertising spending across corporates. Profit forecasts out to the third quarter continue to see downward revisions.

Despite the recent rally in risk markets, sentiment remains bearish and economic data continues to decelerate. The US economy contracted for a second quarter, putting it into a technical recession. Meanwhile, global purchasing managers' indices continued to fall, with some countries now reaching negative territory.

Performance

The abrdn Global Absolute Return Strategies Fund returned -1.30% during the month (net of fees). The benchmark Bloomberg AusBond Bank Bill Index returned 0.12% during this period.

The Fund positioning reflects what we see as a challenging period ahead for markets. At

present, fears around inflation and central bank tightening are dominating market dynamics, a theme we expect to shift as the focus moves to the consequence of weaker growth. As a result, we expect risk premia to rise across all assets. Against this backdrop, we maintain our defensive positions in relative-value strategies and continue to favour short corporate risk positions. We expect earnings to weaken as we move into the second half of the year. In addition, we maintain longs in the US dollar and developed government bonds.

Within our fixed-income exposures, our US interest-rate position has been a strong performer, driven by the decline in US 10-year government bond yields, as the economic outlook continues to deteriorate (this was the biggest monthly decline since August 2019). Similarly, we saw our Australian interest-rate strategy benefit from the sharp drop in yields; we have since exited this strategy after its strong performance. The UK versus emerging-markets (EM) equity relative-value strategy contributed positively, as the UK benefitted from the rebound in developed-market (DM) equities while EM equities remained weak. Our US equity low volatility index versus the US market was the biggest detractor this month, along with our positions in Asian markets, including our Asia high-yield, short Japanese government bonds and Chinese versus DM equity strategies. This was driven by the negative move in Chinese markets, with the Covid-19 resurgence and fines and scrutiny for key technology giants weighing on investor sentiment in the region.

Activity

During the month, we reduced our Asian high-yield positions given the current pressure on Chinese markets. We also increased our interest-rate exposure in the portfolio, increasing our US interest-rate position and reducing our short position in Japanese government bonds. The move to continue adding interest-rate exposure is in line with our long-term view of economic deceleration while being reactive to near-term risks. We also increased our US dollar exposure during the month by increasing our position in the US dollar versus Chinese renminbi strategy, as we moved to increase our defensive positioning against the current economic climate.

Outlook

There are three broad scenarios that we expect to dominate market pricing going forward: a US

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 ESTR plus 5% 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 equities, 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 5% per year, before charges. We would expect it to exhibit annualised volatility** of between 4% and 8% in ordinary market conditions or, more broadly, between one-third and a half of the risk of global equities***.

*Cash returns are currently referenced to ESTR (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

recession, stagflation and a 'soft-landing' scenario, where the Fed manages to correctly calibrate the required degree of policy tightening and avoids a recession.

As a consequence of this view, we have positioned the Fund to take advantage of tightening financial conditions into slower growth via a short bias towards corporate risk. In addition, given the significant amount of dispersion expected across regions and sectors, we have been focusing on relative-value positions. On the developed-market government bond side, we have been adding exposure on a weaker growth path and we maintain a long US dollar bias within the currency strategies.

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.

Contact us
Telephone:
1800 636 888 or +61 2 9950 2853 if
calling from outside Australia
Email: client.service.aust@abrdn.com

abrdn.com.au

Important information

Issued by abrdn Australia Limited ABN 59 002 123 364 AFSL No. 240263. This document has been prepared with care, is based on sources believed to be reliable and opinions expressed are honestly held as at the applicable date. However it is of a general nature only and we accept no liability for any errors or omissions. This is not an offer of securities. A Product Disclosure Statement (PDS), application form, and Target Market Determination (TMD) is available for each Fund by calling abrdn Australia Limited Client Services on 1800 636 888, at www.abrdn.com/aus, or from your financial adviser. This document has been prepared without taking into account the particular objectives, financial situation or needs of any investor. Investments are subject to investment risk, including possible delays in payment and loss of income and principal invested. It is important that before deciding whether to acquire, hold or redeem an investment in a Fund that investors consider the Fund's PDS, the Fund's appropriateness to their own circumstances, objectives and financial situation and consult financial and tax advisers. Past performance is not a reliable indicator of future results. All dollars are Australian dollars unless otherwise specified. Indices are copyrighted by and proprietary to the issuer.