

31 August 2022

## Market review

August was characterised by weakness across most traditional asset classes, with negative returns in equities and corporate and government bonds catalysed by sharply rising interest rates.

We saw inflationary pressures fall slightly in the US, mainly as a result of price pressures for energy and core items dissipating. However, US Federal Reserve (Fed) Chair Jerome Powell ignited the latest bond sell-off during his speech at Jackson Hole, where he indicated that getting back to price stability would "likely require maintaining a restrictive policy stance for some time". The speech appeared to indicate further hikes at the expense of lower growth later. Nevertheless, it reaffirmed the Fed's commitment to price stability and its push-back on market expectations for an earlier pivot.

In Europe, inflationary pressures continued to rise, with August consumer price index estimates above both the July print and survey expectations. This increased the European Central Bank's (ECB's) focus on the need for front-loading the hiking cycle given the extremely accommodative starting point for interest rates. In addition, a further 25% increase in natural gas futures over the month increased concerns around the prospect of stagflationary conditions, with energy shortages likely to both increase inflation and reduce growth.

The outlook for the global economy grew more pessimistic, as possible rate hikes will lead to a further weakening of the growth outlook in the medium term. We have seen more market participants lean toward this view.

## Performance

The abrdn Global Absolute Return Strategies Fund returned -1.13% during the month (net of fees). The benchmark Bloomberg AusBond Bank Bill Index returned 0.15% during this period.

The Fund's 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. This is a theme we expect to evolve as the focus moves to the consequences of rising interest rates and 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 in developed-market government bonds.

Our equity relative-value trades and our short corporate risk trades performed well. Our positions in US equity low volatility versus US equity, global equity zero hunger and short high-yield corporate bonds were all among the top performers. Our short position in sterling foreign exchange also performed well, as inflation continued to soar in the UK in conjunction with the worsening energy crisis and growing recession fears. Our interest-rate strategies were the biggest detractors, which included our US duration, European real yields and US steepener strategies. Markets have been pricing more aggressive hiking cycles, as inflation continues to rise across developed markets, leading us to diversify our duration exposure. However, we believe that the market is underestimating the timing and magnitude of easing once growth starts to slow materially.

## Activity

During the month, we diversified our duration exposure by adding a European real yields position, a US steepener position and a Brazilian rates position. In Europe, given the ongoing energy crisis and weakening growth outlook, we believe the ECB is unlikely to hike as much as priced in. Similarly, in the US, growing recessionary fears mean there is greater potential for the curve to steepen, with the increasing possibility of cuts being priced further out. We see the current hiking cycle in Brazil coming to an end given that Brazil has hiked rates by nearly 12% in less than two years, giving the country a substantial base to ease policy, as economic conditions

## 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

are likely to worsen into next year. During the month, we also closed our short Japanese government bond strategy, as we believe the drivers of this strategy have deteriorated and upside pressures on yields have diminished.

## Outlook

There are three broad scenarios that we expect to dominate market pricing going forward: US recession, stagflation and a 'near-miss' scenario, where the Fed walks the tightrope 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 equity and corporate bonds. 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.*

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