

31 December 2022

Market review

Global investment-grade corporate bonds fell in December. Sovereign bond yields rose, with the 10-year US Treasury bond yield rising by 27 basis points (bps) to 3.88% while the 10-year German bund yield closed the month 64bps higher at 2.57%. However, credit spreads also contracted. As a result, the total index return for the period was -0.78% (hedged to Australian dollars).

The US Federal Reserve (Fed), European Central Bank (ECB), Swiss and British central banks all raised interest rates by 50bps in December. This marked a deceleration in the pace of monetary tightening, with each having raised by 75bps previously. Each central bank stressed more action was needed to moderate high inflation. In the US, the Federal Open Market Committee highlighted high energy and food prices, but acknowledged that unemployment would be likely to rise in 2023. US inflation stood at 7.1% year-on-year in November, a deceleration from October's figures. ECB President Christine Lagarde has said the Eurozone's predicted recession this winter will be short and shallow, but has flagged rising wages as a contributor to stubborn inflation.

Portfolio review

The Fund underperformed its benchmark in December, due to our holdings in single A rated bonds.

Energy and utility companies underperformed, including Dominion Energy. US banks Citigroup and Bank of America also lagged. Conversely, Barclays was beneficial. Property holdings continued to outperform, including Sirius, Sunac and Shimao.

In December, we bought attractive new euro bank bonds, including the 2029 issue from TD Bank and the senior non-preferred 2030 bonds of Société Générale. In US dollars, we bought the 2033 bonds of Energy Transfer, which has attractive new-issue pricing.

In the secondary market, we bought a long-dated bond from Amgen, which has

been weak following news of its acquisition of Horizon Therapeutics. We also topped up US insurer Centene, which is well priced in its peer group and we see good upside potential. We selectively reduced our euro bank holdings, including BNP Paribas, to raise cash for attractive new issues. We also exited casino owner Vici Properties, taking profits after strong performance.

Outlook & strategy

We remain positive for global investment-grade credit. Credit yields are now at attractive levels, not seen in years, particularly when compared to other more macro-sensitive assets, like equities. We expect the inflows to credit, seen in the last quarter of 2022, to continue. Spreads have been resilient in December, despite global central banks' more hawkish tone and some renewed rates weakness into year-end. Both the ECB and the Fed hiked rates by 50bps in December, broadly as expected, but the broader guidance and forecasts were notably hawkish. The ECB said that rates will need to rise "significantly further" and the Fed increased its 2023 policy rate forecast. The ECB will start quantitative tightening in March, at €15 billion per month until the end of June. December inflation prints, released in early January, showed France and Germany below consensus expectations while US price rises continued to slow. A mild winter in Europe has reduced gas prices and helped cool inflation. Headline inflation in the Eurozone and the US has passed its peak, but it remains much higher than targeted levels for the central banks. Core price inflation still indicates sticky underlying pressures though and is something to closely monitor. In the US, for example, wage inflation due to a still-strong labour market remains a key focus of the Fed in its attempt to reduce demand and control inflation.

Against this overall backdrop, we are comfortable positioning the Fund as more risk facing. In the fourth quarter, we extended the portfolio's spread and interest-rate duration, and reduced cash and government bonds holdings. We remain overweight in subordinated debt. We prefer banks to non-financials,

Investment strategy

The Fund is actively managed and may invest in a wide range of bonds (e.g. corporate bonds including high yield bonds, government backed securities, overseas bonds, index-linked bonds, floating rate notes ('FRNs') and asset backed securities ('ABSs')) and/or money market instruments) in order to take advantage of opportunities identified.

Investment objective

The Fund aims to provide long term growth and outperform the Benchmark over rolling 3 year periods (before deduction of fees, costs and taxation) by investing predominantly in global investment grade bonds.

given attractive valuations and robust fundamentals, with the sector's earnings benefitting from higher interest rates globally. We still favour European to US credit markets, due to more favourable valuations as European markets remain closer to recessionary levels. Overall, we think fundamentals in both the US and Europe, which include solid balance sheets for corporates, stable banking systems and access to liquidity, should support valuations at current levels even if economies in the US and Europe enter recession during 2023.

Specific share class performance is available on the relevant factsheet.

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Companies selected for illustrative purposes only to demonstrate the investment management style described herein and not as an investment recommendation or indication of future performance.

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

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