

31 July 2022

## Market review

Global investment grade corporate bonds rebounded in July. Sovereign bond yields fell sharply, with 10-year US Treasury yields finishing 32 basis points (bps) lower at 2.65%, while the 10-year German bund yield closed the month 53bps lower at 0.81%. Credit spreads also narrowed. As a result, the total index return for the period was positive, at 3.28% (hedged to Australian dollars).

Both European and US central banks hiked interest rates in the month. The European Central Bank (ECB) raised interest rates by 0.5% in July, its first hike in over a decade. July's inflation print showed 8.9% year-on-year price rises across the Eurozone. The US Federal Reserve (Fed) raised interest rates by 0.75%, a repeat of its last meeting in June. The move was in line with expectations, with Chair Powell indicating that the bank's September action is yet to be decided, as data shows signs of economic weakness. US GDP contracted in the second quarter, putting the economy in a technical recession. While economists still fear a European recession later in 2022, tourism has supported economic growth across the region.

## Portfolio review

The Fund outperformed its benchmark in July, thanks to good stock selection and an overweight in BBB rated holdings.

Looking at individual issuers, aerospace holdings performed well, including General Electric, Howmet Aerospace and Boeing. Netflix outperformed, as results were above analyst expectations, even as the company lost a million subscribers in the second quarter. In utilities, Dominion Energy and National Grid performed well.

On the downside, in risk-on conditions, our increased holding of cash and US Treasuries weighed on returns. Chinese property holdings were again detractors, including CIFI.

We used our elevated cash position to buy attractive, well-priced bonds. In the primary market, in euros, we bought the new 2029 green bonds of SSE. In US dollars, we bought the 2025 and 2029 bonds of materials producer Celanese, as well as the 2052 US dollar bonds of PepsiCo.

In the secondary market, we bought cheaply

priced short-dated bonds, including Heathrow Airport. We switched out of Bank of America's 2028 pound sterling bonds to buy the recently issued 2026 US dollar bonds, which have better upside potential. We also sold down carmaker Toyota.

## Outlook & strategy

July has been a positive month for global credit, with government bond yields falling and credit spreads retracing some of June's widening. Credit spreads had priced in a recession in June and a complete cut-off of Russian gas. The worst case has not occurred; gas flows have returned after the Nord Stream 1's planned maintenance, albeit at a lower level. We think Russia will continue to use this threat, keeping flows lower to maintain leverage. Dependent countries, like Germany, could eventually see gas rationing if storage levels do not guarantee coverage for the upcoming winter. In the US, strong employment data, with the recently reported robust job numbers, coupled with continued inflationary pressures gives the Fed a green light to continue its tightening path. This has raised concerns that the Fed might over-tighten. We have also started to see some tightening in commercial lending standards (e.g. Commercial & Industrial and Commercial Real Estate), and these tightening trends could become more entrenched in the second half of 2022 as banks proactively plan ahead.

Having increased our cash holdings in May and June, we utilised some of our dry powder at the beginning of July. We took advantage of attractive market valuations to add to defensive higher quality issuers and some selective opportunities in short-dated debt. We have maintained our overall short interest rate duration position; however, we have reduced our short in Euro rates and are positioned closer to neutral in US rates. We think current valuations are attractive on a one to three-year time horizon but expect more volatility ahead, as it remains unclear how much growth will drop when inflation rolls over and how much gas Russia will supply until autumn. Given the backdrop of attractive valuations versus short-term uncertainties, we maintain a balanced and marginal overweight credit risk position with a moderate allocation to cash and government bonds that provides us with a buffer and flexibility as we head into autumn.

## 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.

*Specific share class 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.*

*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.*

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