

31 August 2022

Market review

Global investment-grade corporate bonds fell in August. Sovereign bond yields rose, with 10-year German bund yields closing the month 80 basis points (bps) higher at 1.61%, while the 10-year US Treasury yield rose by 55bps to 3.02%. Credit spreads finished the month roughly flat. As a result, the total index return for the period was negative at -3.16% (hedged to Australian dollars).

Globally, bond investors' fears intensified as Jay Powell spoke in Jackson Hole. While July's US consumer price index was slightly below estimates, at 8.5%, the US Federal Reserve (Fed) Chair was markedly hawkish. He committed to control inflation even if the labour market weakens and acknowledged that rate hikes would bring pain for households and businesses. The US employment picture has been mixed, with jobless claims rising then falling in the month. In Europe, sovereign bond yields moved sharply higher across the continent in anticipation of hikes from the European Central Bank in September, perhaps as high as 0.75%. High energy and food costs pushed Eurozone inflation to a record 9.1%, according to August's flash estimates. While corporate and emerging market bond prices also fell over the period, riskier bonds generally outperformed.

Portfolio review

The Fund underperformed its benchmark in August, mainly due to an overweight holding of BBB rated and high yield bonds. In terms of holdings, banks and financials weighed on returns. This included our overweight positions in Lloyds, Barclays and Deutsche Bank. On the upside, our short dated US Treasury holdings performed well. Chemicals producer Orbia outperformed, as did chipmaker SK Hynix.

In the primary market, we bought the attractive new 2031 euro bonds from utility issuer Eurogrid. In banks, in euros, we bought the 2032 Tier 2 bonds of Swedbank. In US dollars, we bought Apple's 2052 bonds and the 2032 bonds of medical technology issuer Becton Dickinson and Company.

We continue to buy attractive shorter dated bonds, including the 2025 bonds from Wells Fargo in euros and the 2025 bonds of CRH in US dollars. We also switched our Anglo American exposure, selling the 2025 issue euro bonds to the in the 2029 pound bonds, which offer attractively priced. On the sell side, we reduced our high yield holdings, selling Howmet Aerospace and Teva Pharmaceuticals.

Outlook & strategy

The near-term outlook remains challenging for corporate bonds. Lower gas flows from Russia, resulting in higher energy and electricity prices, and the potential rationing of gas consumption over the winter will likely tip Europe's economy into a recession. Higher energy prices translate into higher headline inflation, forcing central banks to keep hiking until inflation rolls over. Core inflation, which excludes energy and food price inflation, is lower but keeps increasing. It will likely take the demand dampening effect of a recession to change the current trend, which we expect to see in winter. On the upside, credit spreads for European investment-grade credit are already pricing in a mild to average recession, and all-in yields north of 3% are the most attractive in the last 10 years. In the US dollar market, spreads have rebounded since mid-June, but they still trade wide of average levels since the financial crisis.

We see value in our asset class over the medium term. In the short term, credit spreads and interest rates will remain volatile and therefore the Fund remains positioned with a moderate allocation to cash and government bonds, and close to flat in terms of credit risk relative to the benchmark. We are underweight US dollar credit, due to its tighter valuation than the euro credit market. In particular, we are underweight the long end of the US dollar curve. We expect that an active new issue market this autumn will provide opportunities to buy credits we like at attractive concessions.

Specific share class performance is available on the relevant factsheet.

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.

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.

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.