

30 September 2022

Market review

Global investment-grade corporate bonds fell in September. Sovereign bond yields rose, with 10-year US Treasury bond yield rising by 63 basis points (bps) to 3.83% while the 10-year German bund yield closed the month 50 bps higher at 2.11%. Credit spreads also widened. As a result, the total index return for the period was negative at -4.85% (hedged to Australian dollars).

Investors pulled back from global bonds as high inflation and the threat of recession weighed on sentiment. Central banks across the G7 raised rates, with the exception of Japan. In the US, the Federal Reserve (Fed) raised rates by 0.75% at its September meeting. While August's unemployment rate, at 3.7%, was higher, weekly jobless claims hit a five-month low late in September. The ECB also raised rates by 0.75% as annual consumer price inflation across the eurozone rose to 10% in September.

Portfolio review

The Fund outperformed its benchmark in September thanks to strong asset allocation.

Property holdings underperformed. In particular, overweight positioning in Sirius and Cromwell detracted. Amid rising rates, long-dated bonds weighed on returns including JAB Holding Company, Apple and Orbia. On the upside, in a risk-off environment, our US Treasuries performed well. Shorter-dated bank holdings held up well, including Wells Fargo, Bank of America and Mitsubishi UFJ Financial.

In the primary market, our purchases focused on attractive new bonds from quality issuers. This includes the 2031 euro bonds of Medtronic and Ørsted's 2042 pound bond. We bought selective new issue bank bonds including the 2025 issue of Mitsubishi UFJ Financial Group and the 2024 bonds of TD Bank.

In the secondary market, we topped up our holding in Western Midstream, which is a contender to be uprated. We switched out of General Motors' 2048 bonds for its

better value 2032 bonds. On the sell side, we selectively reduced our exposure to UK banks such as NatWest.

Outlook & strategy

We maintain our short-term cautious, medium-term constructive view of global credit. Markets will continue to see increased spread and rates volatility until inflation rolls over and central banks have increased base rates further. We think we will reach that pivot point at the end of the fourth quarter or early in 2023. Markets are currently pricing a Federal Funds rate peak of 4.6% in March 2023 and the ECB deposit rate of 3% in July 2023. While you can argue for higher base rates in light of high inflation, we think the hiking cycle appears close to being fully priced. While fundamentals will be challenged by a possible recession, we have seen some large fiscal packages being announced in Europe to deal with the energy crises which should buffer the inevitable growth slowdown. Valuations are difficult to dismiss, with yields north of 5% for our asset class, and credit spreads already pricing in a mild to average recession in Europe. In the US, spreads remain wide but have not quite reached recessionary levels yet, so we remain underweight in US risk compared with Europe; however, we think the US should be relatively better supported than other credit markets. Going forward, our primary concern with US credit is deteriorating margins due to rising costs and weaker demand as the economy slows in response to Fed interest rate increases. We continue to have a bias for higher quality, defensive, noncyclical issuers in the US credit market. In particular, we favour the short end in the US where break-even opportunities are attractive, although are not looking to entirely close our short position in the long end just yet. In the meantime, we maintain our higher allocation to cash and short-dated Treasuries and shorter interest rate duration compared to our benchmark. This balances off overweights in subordinated corporate and bank debt, which we think looks attractively priced.

Specific share class performance is available

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.

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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