

31 August 2023

Market Review

Global investment-grade (IG) corporate bonds fell in August. While the 10-year German Bund yield closed the month three basis points (bps) lower at 2.47%, the 10-year US Treasury yield rose by 15bps to 4.11%. Credit spreads also widened. As a result, the total index return for the period was -0.53% (hedged to Australian dollars).

There has been a softening in economic data in August, particularly in Europe and China, leading to growing concerns about the near-term outlook. Bonds and equities regained some ground towards the end of the month as optimism about a soft landing increased. At Jackson Hole, US Federal Reserve (Fed) Chair Powell delivered a less hawkish speech than the previous year, easing fears of further significant interest rate hikes. Other factors, such as concerns over Chinese property developers and the Italian government's tax on banks' 'extra profits', also affected investment sentiment. Towards the end of the month, the Job Openings and Labor Turnover Survey for July indicated that the labour market's tightness was easing further, with the quits rate returning to its pre-pandemic level.

Portfolio Review

The Fund underperformed the benchmark in August, as exposure to A rated bonds detracted.

Anglo American detracted, as economic data suggests a more challenging landscape. In banking, negative contributions from Bank of America, Citigroup and Wells Fargo were partially offset by positive performance from selective holdings in Virgin Money, UBS and HSBC.

In the primary market, we bought attractive new US dollar issues, including the 2053 bonds of McDonald's, the 2028 bonds of Ingersoll Rand and the 2054 bonds of ConocoPhillips. In euros, we bought the 2033 bonds of LVMH and the 2028 bonds of Amprion.

We tactically increased the Fund's cash positions over the month, as we expect

a busy primary season from September onwards. This included selling KBC, which has outperformed recently, and Berry Global, to reduce our high yield risk.

Outlook

US activity has been resilient in the face of Fed tightening, while both core and headline inflation have moderated, raising hopes for a possible soft landing. However, leading indicators still point to trouble ahead, and the historical record is not promising for the Fed. The Conference Board leading indicator has never been this weak outside of a recession, and soft landings are the exception, not the norm, in past tightening cycles. As a result, while a downturn does not appear to be imminent, we continue to expect a US recession to occur around the turn of the year.

Credit conditions are tight and getting tighter due to the impact of higher interest rates and the banking sector turmoil earlier this year. This will weigh heavily on activity as the year progresses. Activity data elsewhere is generally weaker. The eurozone's 'winter recession' has been revised away, but surveys suggest the economy is entering the second half of the year with very little momentum. It is difficult to see how the UK can avoid a recession given the already stagnant growth rate combined with the lagged effects of past tightening about to hit the economy. Our forecasts show that rates are now very close to their peak in the US and the eurozone. The Bank of England likely has more to do due to idiosyncratic inflation risks in the UK. There are upside risks to all these forecasts in the near term if inflation or activity data proves more resilient than expected. We continue to expect the major central banks to start easing policy significantly in 2024.

Valuations for euro and sterling IG credit are reasonably attractive, with spreads above long-term averages but not fully priced for a US-led global recession. Valuations for US dollar IG credit, which had a strong rally at the end of July, are less attractive and price in less of a negative outcome from either a weaker economy or a more aggressive Fed. Within the Fund, we remain more weighted

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.

toward both the sterling and euro markets than the US. We remain overweight banks and underweight non-financials, while preferring non-cyclicals to cyclicals.

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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Important information

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