

Capital Group Global Corporate Bond Fund Hedged (AU)

Market review

- It was another difficult quarter for global investment grade corporate bonds as inflation remained elevated and major central banks were steadfast in their rate hiking paths.
- The US Federal Reserve (Fed) and the European Central Bank (ECB) raised interest rates over the quarter; the Fed by 150 basis points (bps) and the ECB by 125bps
- Spreads tightened over the course of the quarter before retracing the move into quarter end and closing up slightly wider at 180bps. In this environment, global investment grade corporate bonds posted both negative total and excess returns.⁴

Portfolio review

- For the three months ended 30 September 2022, Capital Group Global Corporate Bond Fund Hedged (AU) returned -4.7%¹ before fees, while the index returned -4.8%². Net of fees, the fund returned -4.8%³. Over the one-year period, the portfolio returned -17.4%¹ before fees and -17.9%³ after fees. The index returned -17.7%² over the one-year period.
- Security selection had a beneficial impact on relative results, but sector/industry selection detracted. The portfolio's duration exposure also weighed on relative returns, while curve positioning was marginally positive.
- Security selection within the banking sector was detrimental to relative returns, especially overweight positions in Credit Suisse and HSBC, though an underweight to the sector helped slightly. Credit Suisse continued to suffer on the back of negative news headlines. It failed to reassure investors about the strength of its balance sheet. Bond prices dropped to record lows over the quarter, reflecting concerns about the company's restructuring programme. Credit default swaps also spiked, meaning the cost of buying insurance against it defaulting on its debt soared to record highs. Spreads for the banking sector in general have been trading wide. Banks are inherently confidence-sensitive levered institutions that in the current market environment and backdrop could tend to underperform the broad index during risk-off periods. In our opinion, HSBC remains a solid bank with operations in both the UK and Hong Kong. Business risks appear manageable even in a recessionary scenario thanks to strong long underwriting processes, rising rates, strong capital and excellent liquidity.
- Security selection in the insurance sector detracted, particularly an overweight holding in Zurich Insurance Group. It's been a difficult year for insurers who have continued to face losses and have also suffered on the back of worldwide economic uncertainty.
- Security selection in the communications sector benefitted relative returns. A non-index position in Netflix was the portfolio's largest positive contributor at an issuer level. The company lost less subscribers than anticipated during the second quarter, projected a rapid return to growth and grew its market share.

- Security selection in electric sector also helped. Overweight positions in Pacific Gas and Electric (PG&E) and Edison International were among the portfolio's largest positive contributors to relative returns. Utility companies have continued to do well in these choppy markets and uncertain times. PG&E has benefitted from a number of new positive developments over the past quarter, including on the legislative front with the passing of the undergrounding bill, which removes much of the regulatory uncertainty surrounding wildfire risk reduction for the company and the passing of a bill that provides funds to keep the company's nuclear plan.

Outlook

- Credit markets are likely to remain volatile in the last three months of 2022. Along with broader risk assets, they remain vulnerable to hawkish central banks, disappointing macroeconomic data, ongoing geopolitical tensions and the resulting energy crisis.
- While credit spreads remain near their long-term averages, they could go wider as the risk of recession rises.
- Despite the challenging backdrop, investment-grade corporate bonds have become more attractive as corporate fundamentals continue to improve, with relative debt levels falling across both European and US investment-grade issuers.
- Valuations also look attractive as global investment-grade corporate yields have risen given higher government bond yields and wider credit spreads. Corporate fundamentals are robust, and supply and demand dynamics are relatively neutral for spreads. This should help to limit the magnitude of any potential sell-off.
- Higher yields mean that investors now have the potential to earn more income from bonds. Over time, this could provide more of a cushion for total returns, even if price movements remain volatile. For an active manager, the market could present compelling opportunities to find value, though selectivity is still crucial in the current environment.

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Security returns are total returns as shown in local currency terms, unless otherwise stated.

¹ Returns are before management fees and expenses, in Australian dollar terms. Source: Capital Group

² Bloomberg Global Aggregate Corporate Total Return Index. Hedged to AUD. Source: Bloomberg

³ Returns are net of fees at maximum management fee, in Australian dollar terms. Source: Capital Group

⁴ Bloomberg Global Aggregate Corporate hedged to USD Index. Source: Bloomberg

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