

Capital Group Global Corporate Bond Fund Hedged (AU)

Market review

- After one of the worst periods for fixed income markets in recent history, the final quarter of 2022 saw bond markets rally and pare some of their year-to-date losses. The change in sentiment was driven by rising market expectations that inflation might have peaked and that with the global economy slowing, central banks might not need to be as aggressive with tightening monetary policy.
- The US Federal Reserve (Fed) and the European Central Bank (ECB) both raised interest rates by 125 basis points (bps) over the quarter.
- Credit spreads tightened over the quarter. Global investment-grade spreads ended Q4 32 bps lower at 147 bps. This is still significantly above their level of 97 bps on 1 January 2022.

Portfolio review

- For the three months ended 31 December 2022, Capital Group Global Corporate Bond Fund Hedged (AU) returned 3.1%¹ before fees, while the index returned 2.7%². Net of fees, the fund returned 3.0%³. Over the one-year period, the portfolio returned -14.8%¹ before fees and -15.3%³ after fees. The index returned -15.4%² over the one-year period.
- Security selection was the biggest contributor to fund results, adding 62 bps to gross excess returns. These gains were partially offset by losses from sector/industry selection, which cost 17 bps of relative returns.
- Security selection within the banking sector was the largest overall contributor, in particular HSBC, which made the highest contribution to returns for the fund. HSBC's bonds benefitted from an easing of COVID restrictions in China, which helped to significantly reduce some of the key tail risks that were facing the bank. However, the strength of the banking sector over the quarter meant that relative results were negatively impacted by underweight positions in the sector, with a below-index weight in Citigroup the largest overall detractor. Other bank underweights that detracted included Barclays, Bank of America and JPMorgan Chase.
- Security selection in the Electric sector was a further contributor to fund returns. This included overweight positions in Pacific Gas and Electric (PG&E) and Edison International, which have both continued to do well in these uncertain times. Bonds from both companies were within the top 5 contributors to portfolio returns by issuer.
- Security selection and an overweight to the consumer cyclical sector benefitted relative returns. The largest contribution was the fund's non-index position in Netflix. The company once again beat market expectations in its third-quarter earnings release.
- The largest detractor from fund relative returns at a sector level were holdings in the Treasury market, which were impacted by tightening credit spreads.

Outlook

- Stocks and bonds rarely fall in tandem in a calendar year - 2022 was one of only a few exceptions over the past 45 years. Aggressive central bank tightening and geopolitical concerns hit bond markets hard. Yields and credit spreads increased significantly, resulting in negative returns across the full range of fixed income sectors including investment grade.
- Global investment-grade markets have since rallied, paring some of these losses as the idea that central banks will move towards easing monetary policy in 2023 has taken hold.
- As we begin 2023 the outlook for the sector is therefore balanced. Spreads are now trading at levels that do not reflect the likely recessions in the US and Europe in 2023. If inflation proves to be stickier than expected and central banks continue to prioritise price stability over financial stability, investors could be disappointed and would need to reprice a deeper recession and/or higher terminal rates for this hiking cycle. Currently, the consensus expectation is for the Fed to start cutting rates in the second half of 2023.
- After the repricing in 2022, global investment-grade corporates look attractive from a yield perspective. Moreover, if correlations between core fixed income and risk assets return to normal as expected, the asset class's relatively long duration means it could also provide diversification from equities and capital preservation if risk sentiment deteriorates.

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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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