

Capital Group Global Corporate Bond Fund Hedged (AU)

Market review

- Bond markets came under pressure amid rising inflation and central bank actions to deal with it. The US Federal Reserve moved to reduce its bond-buying programme and indicated at least three interest rate hikes in 2022. The European Central Bank (ECB) vowed to scale back its pandemic-related bond-buying activities. And the Bank of England raised interest rates for the first time in three years.
- Global investment grade corporate bonds had a volatile fourth quarter given more hawkish major central banks and the emergence of the Omicron COVID-19 variant. At their widest over the quarter spreads widened by 17 basis points (bps) to 105bps at the end of November from a starting level of 88bps on 30 September 2021. As concerns surrounding the Omicron variant receded spreads retraced some of that widening in December to end the quarter at a level of 97bps.⁴
- The asset class posted negative total (in US dollar unhedged terms) and excess returns over the quarter. In US dollar hedged terms total returns were flat. BBB rated bonds lagged higher quality tiers, while Financials underperformed Industrials and Utilities. Regionally, on an excess return basis, US dollar denominated bonds did slightly better than euro corporates. For the full year, however, even though the asset class posted negative total returns, in both US dollar unhedged and hedged terms, mainly driven by rising government bond yields, excess returns were positive.⁴

Portfolio review

- For the three months ended 31 December 2021, Capital Group Global Corporate Bond Fund Hedged (AU) returned 0.0%¹ before fees, while the index also returned 0.0%². Net of fees, the fund returned -0.1%³. Over the one-year period, the portfolio returned -1.1%¹ before fees and -1.7%³ after fees. The index returned -1.0%² over the one-year period.

Areas that helped the portfolio

- **Security selection** at the portfolio level strongly benefitted relative returns. At an individual issuer level, a non-index position in **Petroleos Mexicanos** was the portfolio's largest positive contributor to relative returns. The bonds continued to benefit from a strong oil price environment, government support and a recently announced liability management exercise.
- A non-index holding in **Huarong Finance** was also beneficial. The firm reported that it had agreed to an injection of equity capital. The bonds were purchased at attractive valuations given the sharp decline in price earlier in 2021 and our analyst's belief that they would benefit from government support, which ultimately eventuated.

Areas that hurt the portfolio

- **Curve positioning** weighed on relative results, although this was mostly offset by the portfolio's **duration exposure**.

- Security selection in the **energy** and **technology** sectors further detracted. Within the energy sector an overweight holding in **Energy Transfer Operating** was among the portfolio's largest detractors from relative returns. The company came under pressure due to environmental concerns.

Outlook

- Rising inflation has led to concern about monetary policy tightening from major central banks. COVID-19 also remains a risk. Although valuations are stretched, investors' demand for yield and improving issuer credit fundamentals should be supportive. However, given an increasingly asymmetric risk/return profile, selectivity is key. A cautious overall credit risk stance is warranted but, using its fundamental bottom-up approach, the investment team still sees select opportunities in global credit markets.
- The investment team favours US midstream energy companies (as beneficiaries of stable oil prices), and defensive and regulated US utilities that offer attractive opportunities given the complexity of the capital structure. While these companies' leverage ratios are likely to trend slightly higher to finance the clean energy transition, their profits and cash flows should also increase. The investment team has been investing in, and engaging with, those companies that are increasing their focus on environmental, social and governance factors. They also see opportunities in software and cloud companies as COVID-19 accelerated many of the pre-existing secular trends. However, they tend to avoid companies that are likely to engage in more shareholder friendly activities such as certain pharmaceuticals that are likely to look for sizeable mergers and acquisitions opportunities funded by debt.
- The euro credit markets remain uninspiring given tight valuations and a potentially less supportive ECB.

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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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