

28 February 2023

## Market Review

Global investment-grade corporate bonds fell in February. Sovereign bond yields rose, with the 10-year German bund yield closing the month 36 basis points (bps) higher at 2.65% and the 10-year US Treasury bond rising by 41bps to 3.92%. Credit spreads were roughly flat. As a result, the total index return for the period was -2.64% (hedged to Australian dollars).

In the US, the Fed raised the federal funds rate by 0.25% in its February meeting, a further deceleration in the pace of interest-rate hikes. However, strong retail sales and employment data gave concern that there may be higher rates to come. Furthermore, late in the period, data showed January's annual inflation rate to be unexpectedly higher. Consumer confidence fell, according to the Conference Board's latest report. The European Central Bank (ECB) increased rates by 0.5% in February. ECB president Lagarde indicated the hikes would continue, reiterating that the central bank would "stay the course" to return inflation back to the target of 2%. Eurozone annual inflation was 8.6% in January, down from 9.2% in December. However, February inflation data from France and Spain, published late in the month, was higher than expected.

## Portfolio Review

The Fund marginally outperformed the benchmark. However, positioning in single A rated bonds detracted.

Longer dated bonds detracted over the month, including UnitedHealth, Oracle and Lowe's Companies. Utilities holdings detracted, including Duke Energy and NextEra. On the upside, banks performed well, including JPMorgan, Deutsche Bank, Virgin Money and BPCE.

In the primary market, we bought attractive euro new issue banking bonds, including the 2026 callable bonds from Nordea Bank and Virgin Money's 2028 bonds. We also bought Orsted's euro 2035 issue. In US dollars, we bought Amgen's new 2043 bond and Oracle's 2053 bonds.

In the secondary market, we added a new

holding in RELX, buying the 2030 US dollar bonds, which is one of our top choices in the media sector and favourably rated by our analysts. We switched out of Tesco's euro bonds to buy their cheaper longer-dated pound sterling bonds. We also took profits in Omega Healthcare Investors.

## Outlook

Rates expectations have been re-pricing higher in February in the US and Europe due to robust economic data. Europe will probably avoid a recession this year thanks to the combination of milder winter weather, a sharp drop in gas prices and the reopening of China, an important trading partner for the continent. However, February's data showed inflation no longer slowing, with Europe's and the United States' most recent CPI prints surprising slightly to the upside. While many inflation drivers, like energy prices, are reversing, core inflation has been more persistent due to tighter labour markets and the fundamental strength of global services sectors. For the ECB and the Fed, this means staying in a more hawkish and data dependent mode for the time being, until there is further proof of weakening underlying economic data and further slowing of inflation. European investment grade credit has shown a fairly resilient spread performance in this environment last month, despite the upward pressure on the rates side. US investment grade has come under a little pressure during February due to heavy supply. For credit markets, stronger underlying economic data are not necessarily negative, given a still strong economy supports the credit quality of corporates and in particular cyclical issuers. Additionally, absolute index yield levels comfortably above 4% in Europe and 5% in the US have made the asset class more interesting, supporting fund flows and creating an ongoing positive technical that since October last year. In the short-term, we expect credit risk premia to trend sideways and stay range bound. There is also potential for an active primary market with companies going through an (overall positive) reporting season.

We have slightly increased cash levels in

## 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.

our Funds to exploit opportunities in both the primary as well as secondary market in the coming weeks. We have also further reduced exposure to cyclical non-financial issuers in the current strength, given the spread differential between cyclicals and non-cyclicals has fallen to essentially zero and we think an underweight in cyclicals is more appropriate given valuations. Our preference remains for banks over non-financials given attractive valuations of bank debt across the capital structure in combination with overall very strong fundamentals, as well as benefitting from higher interest rates globally through higher net interest margins. On the non-financials side, as described earlier, we have a clear preference for non-cyclicals over cyclicals and also still like corporate hybrid debt out of more resilient sectors including telecommunication and utilities.

*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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