

Capital Group Global High Income Opportunities Hedged (AU)

Market review

- Both emerging market (EM) and high-yield debt declined in the first quarter. Risk assets sold off, as concerns about rising inflation, monetary policy tightening by major central banks, and Russia's invasion of Ukraine all weighed on market sentiment. US high-yield bonds, however, held up better than their US investment-grade counterparts due to their lower duration.
- Within emerging market debt, US dollar-denominated bonds returned -9.3%, as measured by the JPMorgan EMBI Global Index¹. The JPMorgan GBI-EM Global Diversified Index² returned -7.8% in local currency and -6.5% in US dollar terms. High-yield corporate debt, as represented by the Bloomberg US High Yield 2% Issuer Cap index³, returned -4.8% over Q1.
- Recent market weakness has resulted in market yields rising to 5.9% from the lows seen since late 2020, resulting in more attractive opportunities from an income perspective.

Portfolio review

- For the three months ended 31 March 2022, Capital Group Global High Income Opportunities Hedged (AU) returned -6.4%⁴ before fees, in line with the index return.⁵ Net of fees, the fund returned -6.6%.⁶ Over a one-year period, the fund returned -3.4%⁴ before fees and -4.2%⁶ after fees, compared to the index's return of -4.3%⁵.
- **Areas that helped the portfolio in Q1⁷**
 - **EM local currency bonds of South Africa, Brazil and Chile**
 - Despite the difficult market backdrop, there were a number of positive contributors. For example, positions in the EM local currency sovereign bonds of resource rich countries South Africa, Brazil and Chile all contributed positively to total returns against a backdrop of rising commodity prices.
- **Areas that hurt the portfolio in Q1⁷**
 - **Russia, Ukraine and Belarus**
 - Holdings in Russian local currency bonds, both nominal and inflation-linked, were the portfolio's main detractors from total returns. Russian hard currency bonds also had a significantly negative impact. In addition, positions in Ukraine and Belarus further weighed on the portfolio's total returns.

Outlook and positioning

- The current environment is one marked by heightened uncertainty in terms of geopolitical events, the inflation and economic growth outlook, and the path of interest rates. This comes at a time when valuations across many fixed income sectors are already stretched relative to historic levels.
- The portfolio managers remain cautiously constructive on the longer term outlook for EM debt. They are constructively positioned in Latin America & the Caribbean in both local and hard currency bonds, focusing on countries that have already progressed in tightening monetary policy to combat rising inflation (for local debt) and solid fundamentals and attractive valuations (for hard currency debt).

For US high-yield bonds, consensus is for default rates to remain very benign, and the volume of rising stars is projected to increase substantially in 2022 as credit fundamentals continue to improve. Going forward, credit fundamentals and economic growth are likely to be the most crucial long-term return drivers. The fundamental backdrop for US high-yield bonds remains strong, which should provide a degree of resilience to market returns. The portfolio managers are constructively positioned in the basic industry sector (metals & mining, chemicals) and financial institutions (brokerage/asset managers/exchanges), while defensively positioned in consumer cyclicals (automotive, leisure) and communications (cable & satellite).

Market volatility⁸

- The Russia-Ukraine situation remains extremely uncertain, with each day bringing new developments that can have reverberating impacts around the world. From a financial market perspective, Russian and Ukrainian securities have borne the brunt of the initial fallout. However, past crises show us that it is often the second and third order effects that have the biggest and most lasting impact.
- The economic and financial market implications may be far-reaching. Over the medium to long-term, some key considerations for investors will include the extent and duration of sanctions imposed on Russia, the impact on energy prices (particularly oil and gas) and soft commodities (e.g. wheat), supply chain disruptions (and related de-globalisation trends), potential for entrenched higher inflation, and of course the response of fiscal and monetary authorities to all of these. On the monetary policy front we may see a shift as central banks consider the impact of the conflict, especially on growth, however, so far normalisation seems to remain on track. The US Federal Reserve (Fed) announced its first interest rate hike this year, with officials indicating an aggressive path ahead as the dot plot forecasts six more hikes for 2022. The Fed is also preparing to reduce its US\$9 trillion balance sheet by US\$95 billion a month, likely beginning in May. The European Central Bank looks to be taking a more hawkish stance than expected with a skew towards “inflationary pressure” rather than downside growth. In addition, many major global index providers have started to remove Russian securities from their indices. All of these factors will have impacts on equity and fixed income markets globally.
- The impact on EM will be similar to that in developed markets, although perhaps more strongly felt given EM’s dependence on global growth and generally higher weighting of food and energy in the consumer price baskets. The commodity exporters in EM, however, should benefit from terms of trade gains, which can help correct external and fiscal imbalances and can help mitigate the impact from weaker global growth. The appreciation in many Latin American currencies year-to-date reflects this positive implication. Some EM central banks may be able to look through the spike in inflation, but second-round effects and the de-anchoring of inflation and wage expectations may constrain others.
- The situation remains extremely fluid, but The Capital SystemSM is designed to help us navigate periods of sudden uncertainty and volatility. We have suspended purchases of Russian securities across all our investment strategies and implemented controls in compliance with the sanctions against Russia. Our portfolio managers are closely monitoring the situation and analysing ongoing developments alongside our longer-term focus on fundamentals, and will adjust holdings as needed. As we have done throughout our 90-year history, we will focus on the long-term fundamentals and work closely with our clients as events unfold.

Index returns are shown in US dollar terms while stock returns are total returns as shown in local currency terms, unless otherwise stated. Sources: Capital Group, Barclays Capital, JPMorgan

¹ JPM EMBI Global Total Return. Source: JPMorgan

² JPM GBI-EM Global Diversified Total Return. Source: JPMorgan

³ Bloomberg US Corporate High Yield 2% Issuer Capped Index. In US dollar terms. Source: Bloomberg

⁴ Returns are before management fees and expenses, in Australian dollar terms. Source: Capital Group

⁵ 50% Barclays Capital US Corporate High Yield 2% Issuer Capped Index hedged to AUD, 20% JPMorgan Emerging Markets Bond Index Global hedged to AUD, 20% JPMorgan Global Bond Index - Emerging Markets Global Diversified in USD hedged to AUD, 10% JPMorgan Corporate Emerging Markets Bond Index Broad Diversified hedged to AUD. Sources: Barclays Capital, JPMorgan

⁶ Returns are net of fees at maximum management fee, in Australian dollar terms. Source: Capital Group

⁷ Data reflects absolute contributions to GHIO returns, in US dollar terms

⁸ Click [here](#) for Capital Group's response to the war in Ukraine and visit [Market Volatility | Capital Group](#) for our latest data on portfolio holdings in Russia, Ukraine and Belarus.

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