

Capital Group Global High Income Opportunities Hedged (AU)

Market review

- The US Federal Reserve (Fed) hiked its policy rate more aggressively than originally expected at its June meeting, partially in response to the May inflation report. The central bank's 75-basis-point increase was its largest since 1994. Fed Chair Jerome Powell indicated that a similarly sized hike would be possible at the next policy meeting. Based on futures pricing, markets expect a 3.25%–3.5% target range by the end of 2022.
- The high yield market suffered heavy losses amid rising interest rates and concerns of an economic slowdown. However, high yield bonds did do better than most other areas of the fixed income market, primarily as a result of their lower duration.
- Emerging markets (EM) bonds continued their decline in the second quarter. Persistent concerns about global inflation, less accommodative global monetary policies, and the war in Ukraine all weighed on the asset class. Both local currency bonds and US dollar-denominated issues posted declines. Among US dollar-denominated bonds, investment-grade credits held up better than their high-yield counterparts.
- Within emerging market debt, US dollar-denominated bonds, as measured by the JPMorgan EMBI Global Index¹, returned -10.5%. The JPMorgan GBI-EM Global Diversified Index² returned -2.3% in local currency and -8.6% in US dollar terms. High-yield corporate debt, as represented by the Bloomberg US High Yield 2% Issuer Cap index³, returned -9.8% over Q2.

Portfolio review

- For the three months ended 30 June 2022, Capital Group Global High Income Opportunities Hedged (AU) returned -10.0%⁴ before fees, while the index returned -9.9%.⁵ Net of fees, the fund returned -10.2%.⁶ Over a one-year period, the fund returned -15.8%⁴ before fees and -16.5%⁶ after fees, compared to the index's return of -16.3%⁵.
- **Areas that hurt the portfolio in Q2⁷**
 - **High yield corporate bonds**
 - High yield corporate bonds have suffered on the back of rising US Treasury yields and credit spread widening as the market's focus has shifted towards concerns about slowing growth and the rising risk of recession. Against this backdrop, the consumer cyclical sector was a notable detractor.
- **Areas that helped the portfolio in Q2⁷**
 - **Income return**
 - The portfolio's income return contributed positively towards total returns. However, this only served as a partial offset to negative price return due to higher all-in yields and weaker currencies versus the US dollar in an environment of broad US dollar strength.

Portfolio positioning and outlook

- Markets have started pricing in the potential for an economic slowdown more fully, while at the same time major developed market central banks continue to tighten monetary policy in an attempt to fight high inflation. The US Federal Reserve and the Bank of England both raised interest rates, while the European Central Bank brought forward plans to tighten monetary policy.
- That said, the stark sell-off fixed income markets have experienced year-to-date presents a compelling entry point for investors from a valuation perspective with yields at levels not seen in years.
- However, a lot of uncertainty remains, and market volatility could remain elevated. Against this backdrop, sector and security selection backed by rigorous bottom-up fundamental analysis remains key.
- The portfolio remains tilted towards emerging markets over high yield corporate bonds on valuation grounds. Within EM, there is a modest preference for local currency bonds, which have offered relatively high real yields and attractive duration following steep interest rate hikes. The portfolio is constructively positioned in Latin America with holdings in South Africa, Mexico, Colombia and Brazil. It is defensively positioned in Eastern Europe where yields are relatively unattractive in the Czech Republic and Poland, and in Hungary where inflation remains a concern. Within EM hard currency bonds, there is a preference for higher yielding countries such as the Dominican Republic, Honduras and Sub-Saharan Africa.
- Within high yield, should the probability of a risk of recession rise, spreads could widen further. The portfolio managers are constructively positioned in the financial institutions and basic industry sectors, driven by bottom-up issuer analysis and selection.

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

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