Brandywine Global Income Optimiser Fund

SEP 2022 I Commentary

Investment objective

The Fund's investment objective is to seek to generate a high and consistent level of income in all market conditions over a full market cycle with a secondary objective of capital preservation.

Performance (%)

	1 mth	3 mths	1 yr	3 yr pa	5 yr pa
Fund (net)	-4.76	-4.34	-15.57	-0.62	1.25

Calendar year performance (%)

	2021	2020	2019	2018	2017
Fund (net)	0.90	15.12	8.95	-1.33	-

Fund details

Inception date	May 2017
ISIN	AU60SSB05156
APIR	SSB0515AU

Monthly review

What happened in the market?

The global fixed income market's weakness intensified during the third quarter. While the U.S. Federal Reserve (Fed) initially characterised inflation as being "transitory," it has since pivoted and emphasized the need to aggressively tighten monetary policy. This has included five interest rate increases in the last six months, pushing the federal funds rate from a range between 0.00%-to-0.25% to 3.00%-to-3.25%. The central bank has also telegraphed the need for additional hikes in the coming months. As expected, the Fed also stepped up its quantitative tightening program to shrink its balance sheet. The majority of other central banks have followed suit, including the Bank of England and the European Central Bank (ECB), which have instituted multiple rate hikes. While these actions are increasingly looking like they could trigger a recession, policymakers appear to believe this may be a necessary evil in order to bring down inflation. One notable holdout, thus far, has been the Bank of Japan, although it recently moved to prop up its currency for the first time since 1998.

For the quarter as a whole, sovereign and corporate yields moved significantly higher, pushing their prices sharply lower. Through the first nine months of the year, major bond indexes have registered historically large losses. Meanwhile, inflation in the eurozone hit an all-time high and a multi-decade high in the U.K. Against this backdrop, the yield on the 10-year U.S. Treasury note briefly exceeded 4.0% in late September, the first time since 2008, before ending the third quarter at 3.83%.

What happened in the Fund?

The Fund fell 4.76% (net of fees) over the month of September. The short-dated US Treasuries within the Fund shielded the Fund during a volatile quarter. While on the other side, developed market duration detracted, specifically U.S. Treasuries, as rates moved higher on the back of hawkish comments by developed market central banks and further rate hikes U.S. high-yield and investment-grade detracted; credit spreads widened as risk aversion remained elevated and rates moved sharply higher.

From a positioning perspective, we see increasing risks of recession which justify some ballast within the Fund, including approximately 4.5 yrs. of long-dated (30-year) US Treasury duration. We are tactically looking for opportunities to add duration. The strategy also holds short-dated U.S. Treasury floaters and remains invested in liquid parts of the bond market should further volatility occur. We are selective in our credits, and our corporate credit within the Fund remains allocated to those companies with strong fundamentals and pricing power. We have added some credits we feel comfortable holding for a longer time period, even with spread volatility. Index level spreads are now somewhat compelling, though we may not have seen the peak in credit spreads. With that said, given higher yields, there is a large amount of cushion for further spread widening to occur and still achieve a positive return. We continue to favour lower-quality investment grade securities as well as higher-quality high-yield issuers.

What is the outlook?

We expect that the global economy is getting close to a tipping point owing to the cumulative lagged effects from rapid monetary tightening, and we reflect this caution through safe haven duration and an orientation towards developed market currencies and bonds in our Funds. One thing has shifted for bond investors: the era of zero interest rates is likely behind us. While macro uncertainty persists, we see select income opportunities attractive enough to justify the market volatility.

For the moment, the U.S. economy is holding up relatively well despite the recession in housing. The economy was in technical recession in the first half of the year but underlying real demand has been stable. There is still the possibility of a goldilocks outcome if inflation retreats enough with limited weakness in the labour market. But the odds of recession, in our view, are growing given the Fed's haste to push rates higher. Unfortunately, the rest of the world is in worse shape; global leading indicators are universally negative. We believe Europe is well on its way to a deep recession, and the ECB, whose primary mandate is to stabilize inflation, is tightening into the contraction. China remains stagnant, a by-product of social isolation policies coinciding with efforts to remove speculation from the property sector.

Much of the outlook still boils down to the question of how sticky inflation proves to be. A decline seems inevitable but when, how fast and how far? There are structural elements to the inflation outlook, such as a smaller labour force, an energy crisis and war, but they are hard to measure and handicap. Inflation lagged the economic cycle on the way up and will lag it on the way down, notwithstanding the structural arguments for inflation. The only question is timing. We think we are very close.

Highlights

- Aims to provide an attractive and stable income by investing across diverse sources of income in global fixed income markets
- Seeks the best global income opportunities, with a strong focus on protecting capital
- Seeks to limit downside risk by rotating risk across different sectors of the fixed income market and through tactical hedging of credit and interest rate risk

About us

Franklin Templeton

Franklin Resources, Inc., is a global investment management organisation, operating as Franklin Templeton, which is headquartered in California. Franklin Resources, Inc., provides, through its subsidiaries, deep investment expertise across all asset classes - including equity, fixed income, and multi-asset solutions. Franklin Resources, Inc. is listed on the New York Stock Exchange and has employees in over 34 countries.

Brandywine Global

Acting with conviction and discipline, Brandywine Global looks beyond short-term, conventional thinking to rigorously pursue long-term value. Since 1986, Brandywine Global has provided a range of differentiated fixed income, equity and alternative solutions from its headquarters in Philadelphia, USA and offices around the globe.

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Celebrating MONEY MANAGEMENT 30 Years FUND MANAGER OF THE YEAR 2017 Lonsec FINALIST Global Fixed Income

FUND MANAGER OF THE YEAR 2018 MONEY MANAGEMENT Lonsec WINNER Global Fixed Income

Ratings

Quantitative

MORNINGSTAR ★★★

The Morningstar Analyst Rating™ for Brandywine Global Income Optimiser strategy is 3 stars as at 30 September 2022.

Qualitative

Recommended

Zenith RECOMMENDED

Meet the team

The Fund is led by a team of long-tenured investment professionals who provide a broad range of experience across global sovereign bond, currency, emerging market debt, and corporate and structured credit markets. The portfolio management team includes:

Brian L Kloss, JD, CPA
Portfolio Manager

Anujeet Sareen, CFA
Portfolio Manager

Jack P McIntyre, CFA
Portfolio Manager

Tracy Chen, CFA, CAIA
Portfolio Manager, Structured Credit

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