

Brandywine Global Income Optimiser Fund

DEC 2022 | 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)	-0.32	1.96	-13.54	0.14	1.54

Fund details

Inception date	May 2017
ISIN	AU60SSB05156
APIR	SSB0515AU

Calendar year performance (%)

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

Monthly review

What happened in the market?

The global fixed income market moved higher during the fourth quarter, but this did little to prevent one of the worst years on record for the asset class. There was a risk-on shift early in the quarter in hopes of a monetary policy pivot. However, this abated later due to continued rate hikes and a deteriorating growth backdrop. U.S. high-yield and investment-grade credit spreads narrowed overall during the quarter. U.S. mortgage-backed security spreads also narrowed. In the U.S., the Federal Reserve (Fed) raised rates at its meetings in both November (0.75%) and December (0.50%), bringing the federal funds target rate to a range between 4.25% and 4.50%. The Federal Open Market Committee's median projection for the federal funds rate is set to surpass 5% in 2023, with no rate cuts anticipated until 2024. Both the European Central Bank and the Bank of England aggressively raised rates during the fourth quarter, and, at the end of the year, rates in both regions were the highest since 2008, with more hikes expected in 2023. Finally, the Bank of Japan kept rates on hold during the quarter, but in December, the central bank surprised the market by raising the target range for the 10-year bond from 0.25% to 0.50%. During the fourth quarter, the 10-year U.S. Treasury rate was volatile but overall rose a modest five basis points from 3.83% to 3.88%. Finally, the emerging market debt asset class rallied during the fourth quarter, and their currencies largely appreciated versus the U.S. dollar.

What happened in the Fund?

The Fund fell 0.32% (net of fees) over the month of December. U.S. high-yield corporate credit was the largest contributor over the quarter. All sectors performed well broadly as spreads narrowed; however, metals and mining, as well as leisure names, outperformed. U.S. investment-grade corporates were also accretive, with financials in particular performing well. Currency exposures also contributed over the quarter, specifically the New Zealand dollar, the Japanese yen, the Thai baht and the Euro. After reaching a 21-year high in late September, the U.S. dollar subsequently gave back around half of its gain in the fourth quarter. The reversal was partially driven by concerns the economy could fall into a recession. Peruvian local-currency government bond exposure was also accretive. Developed market duration, specifically U.S. Treasuries and German bunds, was the largest detractor. Developed market bond duration rallied in November on the back of the expectation that the Fed had become less hawkish. However, rates rose in December and reversed any gains as central banks reiterated their commitment to tightening monetary policy to combat inflation.

From a positioning perspective, the Fund added select foreign currency positions, using the U.S. dollar as the funding currency. Most notably the Japanese yen, euro, Australian dollar, Colombian peso and Thai baht were added. The Fund also initiated and subsequently sold a tactical position to the New Zealand dollar over the quarter, which was accretive. We believe the dollar will likely weaken in 2023 given that U.S. relative monetary policy tightening is set to peak and due to decelerating U.S. growth outperformance. The Fund remains invested in developed market bond exposure, primarily via U.S. Treasuries and German bunds. Increasing recession risks justify some safe-haven duration on the long end of the curve (30 years), which we believe is increasingly anchored. The Fund tactically took profits in its corporate bond exposure after spreads narrowed. The team also increased exposure to select emerging market government bonds, including Brazil and Colombia. Finally, the Fund added to its mortgage-backed securities exposure, primarily via U.S. agency pass-through securities.

What is the outlook?

We expect a rebound for corporate bonds in 2023. Investors must contemplate the starting point in terms of price, yield, and spread relative to the economic outlook. And today, that starting point is compelling given the fundamental backdrop, which includes leverage ratios at manageable levels and management teams focused on challenging consumer environments.

Although spread volatility will most likely stay elevated in the short term, yields offer investors compelling income to compensate for the bumpy ride. Reported data shows that corporate profitability is still well above pre-COVID levels which should support high yield issuer access to capital markets.

We are increasingly confident about the destination of bond markets in 2023, with all signs pointing towards a disinflationary environment. We are less certain about the path and timing of the journey. There are numerous signs showing that inflation will peak soon, including, tighter financial conditions and economies slowing at a time when the lag effects of these tight financial conditions are beginning to impact their underlying economies.

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.



Ratings

Quantitative



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

Qualitative



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

With firm since 2009

Jack P McIntyre, CFA

Portfolio Manager

Anujeet Sareen, CFA

Portfolio Manager

With firm since 2016

Tracy Chen, CFA, CAIA

Portfolio Manager, Structured Credit

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