

# Brandywine Global Income Optimiser Fund

SEP 2023 | Commentary

## Investment objective

The Fund's investment objective is to generate a high and consistent level of income over a full market cycle with a secondary objective of downside protection.

## Performance (%)

	1 mth	3 mths	1 yr	3 yr pa	5 yr pa
Fund (net)	-3.27	-4.18	1.09	-3.13	1.49

## Fund details

Inception date	May 2017
ISIN	AU60SSB05156
APIR	SSB0515AU

## Calendar year performance (%)

	2022	2021	2020	2019	2018
Fund (net)	-13.54	0.90	15.12	8.95	-1.33

## Monthly review

### What happened in the market?

After rising over the first half of 2023, the global bond market's gains were erased during the third quarter. The market initially rallied given signs of moderating inflation, expectations for less monetary policy tightening, and hopes for a soft economic landing. While inflation did moderate and global growth was resilient, inflation remained above central banks' preferred level. This led to the Federal Reserve's (Fed) "hawkish pause" in September. While the central bank held the federal funds rate steady at 5.25%-to-5.50%, its forward-looking "dot plot" signalled one more rate hike in 2023. While this was largely expected, the market was disappointed that the Fed signalled that it wouldn't start cutting rates until June 2024, and only pencilled in two rate cuts in 2024. Elsewhere, the European Central Bank (ECB) raised its key interest rate for a tenth consecutive time in September to a record high of 4%. In contrast, the Bank of Japan's (BoJ) monetary policy remained highly accommodative. The 10-year U.S. Treasury rate moved sharply higher, ending the quarter at 4.50%. U.S. investment grade credit spreads widened and posted a negative total return as interest rates moved higher. High-yield credit spreads were flat but generated a modest gain. U.S. mortgage-backed security (MBS) spreads also widened and generated a negative total return as mortgage rates moved sharply higher. Finally, the U.S. dollar gained 3.2% during the third quarter, pushing its year-to-date gain to 2.6%.

### What happened in the Fund?

The Fund fell 4.18% over the September quarter. Within the Fund, developed market sovereign duration was the primary detractor for the quarter, led by U.S. Treasuries, while German bunds detracted to a lesser extent. Interest rates were broadly higher as the market priced out rate cuts in 2024 and anticipated a potential higher-for-longer interest-rate scenario. Select emerging market local currency sovereign bonds and their respective currencies also detracted, specifically Brazil, Mexico, Colombia and Peru. Despite performing well year to date, the emerging market asset class sold off as the U.S. dollar moved higher. Currency exposure to the Japanese yen also detracted as did short European high yield. U.S. high-yield corporate credit was the primary contributor for the quarter, with energy and communications names performing well specifically. U.S. corporate investment-grade exposure was flat in the portfolio despite the asset class performing poorly. Prime U.S. MBS exposure was also flat in the portfolio despite the asset class underperforming. Finally, short exposure to Japanese government bonds contributed. Yields moved higher as the market expects the Bank of Japan could change its negative interest-rate policy.

From a positioning perspective, the Fund continued to roll down the U.S. Treasury curve and initiated a position on the five-year part of the curve while also increasing its allocation to the 10-year part of the curve. While we still believe that a soft-landing scenario is possible, hard-landing risks have increased. Therefore, we prefer the intermediate section of the curve for a soft-landing scenario and bull steepener trade. We also continue to hold long-end (30-year) U.S. Treasury duration for a hard-landing scenario. The strategy trimmed allocation to emerging market local currency sovereign bonds and their respective currencies, specifically to Mexico and Brazil. These allocations had performed well year to date and spreads had narrowed versus U.S. Treasuries, which led us to take some profits in the positions. Tactical allocations to Spanish government bonds and German bunds were also removed during the quarter. Finally, the portfolio also reduced its Japanese government bond short. The strategy added to short-dated U.S. corporate credit exposure during the quarter, primarily to shorter-dated, higher quality high-yield securities given their favourable yield profile. The portfolio remains invested in both investment-grade and higher-quality high-yield U.S. corporate credits. Given higher yields, we believe there is a large amount of cushion for spread widening to occur and still achieve a favourable total return. Finally, the portfolio removed its short exposure to European high yield.

### What is the outlook?

One of our key macro calls for 2023 was that U.S. inflation would fall toward the Fed's 2% target from 6% a year ago. This has played out with core CPI averaging 0.2% month on month for the past three months (2.4% annualized rate). We expect this trend to continue and believe that we are in the late stages of the business cycle, with current economic activity reflecting a renormalization after Covid-19 instead of a new normal. There is no denying that U.S. growth has been much better than expected. However, we believe all signs point towards a slowdown in economic activity stemming from aggressive monetary policy. Consumers are running out of steam, as evidenced by accelerating credit card delinquencies, and businesses are feeling the pain of higher rates, as evidenced by unemployment. Unprecedented U.S. fiscal stimulus has kept the economy afloat, but in our view not for much longer. Elsewhere, developed and emerging economies are suffering from aggressive monetary policy. Europe's composite PMIs are still in contractionary territory and there are no signs that manufacturing is turning the corner, in our view. If oil and natural gas prices remain high, the cost-of-living crisis in Europe could worsen. China remains vulnerable to its property sector downturn and lack of consumer and private business confidence. When all components of this equation are summed, we believe it is hard to see risk assets moving significantly higher in the short- to medium-term. We still like the optionality that bonds offer investors. There is a margin of safety from the recent duration led sell-off—a higher starting point for yields provides a cushion should spreads and yields further widen—and high-quality sovereign bonds should outperform in a flight to safety.

Past performance is not a reliable indicator of future performance.

## Highlights

- The Fund invests in a diversified portfolio of global fixed income securities.
- A professional managed active portfolio, seeking the best global fixed income opportunities.
- Aims 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 options. Franklin Resources, Inc. is listed on the New York Stock Exchange and has employees in over 34 countries.

### Brandywine Global

Brandywine Global looks beyond short-term, conventional thinking to rigorously pursue long-term value for investors. Since 1986, Brandywine Global has pursued long-term value for clients through a wide range of differentiated fixed income, equity, and alternative solutions. The firm thrives on a culture of debate that encourages ideas, respects diverse viewpoints and invites candid discussion. Brandywine Global operates from its headquarters in Philadelphia and offices in London, Singapore, Toronto, and Montreal.

## 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:

### Jack P McIntyre, CFA

Portfolio Manager

With firm since 1998

### Anujeet Sareen, CFA

Portfolio Manager

With firm since 2016

### Brian Kloss, JD, CPA

Portfolio Manager

With firm since 2010

### Tracy Chen, CFA, CAIA

Portfolio Manager

With firm since 2009

### Renato Latini, CFA

Portfolio Manager

With firm since 2007

### Michael Arno, CFA

Portfolio Manager

With firm since 2007

## Ratings

### Qualitative



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