

Western Asset Macro Opportunities Bond Fund

JUN 2022 | Commentary

Investment objective

The Fund seeks to maximize total return through capital appreciation and income by investing in a combination of investment grade, high yielding debt securities and financial derivative instruments.

Performance (%)

	1 mth	3 mths	1 yr	3 yr pa	5 yr pa
Fund (net)	-3.16	-6.48	-23.54	-5.60	-2.06

Calendar year performance (%)

	2021	2020	2019	2018	2017
Fund (net)	-0.91	5.45	15.94	-5.42	14.51

Fund details

Inception date	August 2016
ISIN	AU60SSB00702
APIR	SSB0070AU

Monthly review

What happened in the market?

The economic outlook remained extremely uncertain following Russia's invasion of Ukraine. While supply-side disruptions kept energy, commodity and food prices elevated, the growth implications were clearly negative. Further downside risks to growth came from China's commitment to its zero-Covid policy, which saw severe mobility restrictions imposed in a number of regions, including Shanghai. The combination of higher inflation and the prospect of slower growth posed a significant challenge to policymakers. In the U.S., markets continued to price more interest rate hikes this year, as the minutes from the Federal Reserve's (Fed) March meeting detailed a willingness to tighten aggressively to ensure price stability. Global government bond yields traded in a wide range during May as inflation continued to bedevil central bank policymakers. Despite record inflation levels across much of the developed world, deteriorating economic activity indicators and fears of central banks overtightening shifted the focus toward weaker global growth. Recent hawkish central bank rhetoric helped calm inflation expectations, with breakeven rates across the U.S., Europe and the U.K. declining from recent highs; however, markets continued to weigh the trade-off between central bank policy tightening to curb inflation and its impact on global growth. June was an exceptionally volatile month in fixed income markets. Accelerating Consumer Price Index inflation prints across the globe reaffirmed markets' expectations for forceful monetary policy action by global central banks. While inflation remains the dominant theme, an increasing number of economic indicators disappointed during the month across the U.S., U.K. and Europe, adding to growing fears over the risk of recession.

What happened in the Fund?

The Fund was down 3.16% in June and down 6.48% during the June quarter. The Fund's duration and yield-curve positioning was the most significant detractor on a net basis mainly as a result of overall long U.S. duration exposure. Exposure to investment-grade and high yield credit was also a negative contributor to performance, mainly due to energy and financials. Overall foreign exchange positioning detracted on a net basis while, developed markets foreign exchange was negative for returns, with long Australian dollar and Japanese yen exposures detracting the most. Emerging markets foreign exchange added to performance as the positive effect of long Russian ruble and short Chinese offshore yuan exposures offset the negative impact of long Brazilian real, Polish zloty and Indian rupee exposures. Mortgage and asset-backed securities were negative for returns, with collateralized loan obligations detracting the most. Emerging market debt was a net detractor mainly as result of Israeli and Brazilian debt exposures; exposure to Russia partially offset the negative impact.

Positioning over the quarter reflected the main theme that inflation and growth would moderate into year end and that the U.S. economy would avoid a recession. The Fund's duration was positioned as a butterfly along the curve, being long in both front- and long-end rates, while short in medium-term maturities. With growth and inflation expectations both moderating late in the quarter, we were positioned for a flatter curve belly to bonds. Risk asset exposure in investment-grade and high-yield credit generally increased as spread widening reflected generous implied default rates vs. our growth outlook. A small amount of emerging market exposure was added by receiving in mid-maturity Mexican swaps and a small long position in Poland. Russian swaps were further reduced, some at levels better than the initiation price, and Russian sovereign exposure passively increased as bond pricing increased over the quarter.

What is the outlook?

The key to an improved tone and more stability in fixed income markets is a moderation in inflation. Our base case is that the supply chains will slowly begin to normalise. This trend, combined with the Fed and other major central banks around the world tightening monetary policy along with negative real incomes slowing consumption, should see inflation moderate. In the U.S., there are signs that the housing market is beginning to slow as higher mortgage rates begin to bite. We anticipate inflationary pressures will peak in Q322 and decline into 2023. While global central banks are expected to raise interest rates further in the short term, we believe more aggressive action is already anticipated by the markets. The fundamental headwinds to global growth and inflation remain. These include the reduction of global fiscal stimulus, the withdrawal of monetary policy accommodation and the persistence of secular-related headwinds such as global debt burdens, aging demographics and technology displacement. As growth and inflation moderate and the risks surrounding central bank policy become more balanced, so too should the market environment for fixed income investors.

Highlights

- A total-return focused, unconstrained fixed income fund that invests in a combination of investment grade, high yielding debt securities and financial derivative instruments
- Provides concentrated and opportunistic exposures to investment manager's key themes
- Designed to potentially have low correlations to equity and traditional fixed income over the long term

About us

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Western Asset

Western Asset Management is one of the world's leading fixed-income managers. With a focus on long-term fundamental value investing that employs a top-down and bottom-up approach, the firm has nine offices around the globe and deep experience across the range of fixed-income sectors. Founded in 1971, Western Asset has been recognized for an approach emphasizing team management and intensive proprietary research, supported by robust risk management.



Ratings

Qualitative



For enquiries, please contact Investor Services Team on 1800 673 776, email auclientadmin@franklintempleton.com or visit franklintempleton.com.au.

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