

Western Asset Macro Opportunities Bond Fund

JUN 2023 | 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)	0.37	-0.12	5.73	-4.38	-0.37

Calendar year performance (%)

	2022	2021	2020	2019	2018
Fund (net)	-22.74	-0.91	5.45	15.94	-5.42

Fund details

Inception date	August 2016
ISIN	AU60SSB00702
APIR	SSB0070AU

Monthly review

What happened in the market?

During the second quarter of 2023, risk assets gained as concerns over a near-term economic hard landing eased. The quarter was initially dominated by market anxiety over the U.S. debt ceiling as negotiations between the Biden administration and Republican House leadership approached the “X-date” when the Treasury Department could run out of cash. Ultimately, Republicans and Democrats struck a deal that entailed a federal spending cap and a suspension of the debt ceiling until 2025, which was approved by Congress and signed into law, averting a potential major risk event for markets. Softer inflation readings set the stage for the Federal Reserve (“Fed”) to leave the fed funds target rate unchanged at 5.00%-5.25% in June after hiking it by 25 basis points (bps) in May. This was the Fed’s first rate pause since its tightening cycle began in March 2022. However, in what was interpreted by markets as a “hawkish pause,” the updated Summary of Economic Projections showed that the median Federal Open Market Committee (FOMC) member projected two more quarter-point hikes this year to a peak target rate of 5.50%-5.75%. At the end of the quarter, fed funds futures contracts priced in an 80% chance of a rate hike at the July FOMC meeting. In Europe, the European Central Bank (ECB) hiked the deposit facility rate by 50 bps over two consecutive meetings to 3.50% as had been widely expected. ECB President Christine Lagarde highlighted that a July hike is “very likely” and that the ECB was “not thinking about pausing.” The ECB also announced a plan to end reinvestments under the Asset Purchase Program from July 2023. Over the quarter, U.S. Treasury (UST) yields rose and the yield curve flattened, with the 2s-10s segment flattening and the 5s-30s segment inverting again. Two-year UST yields rose from 4.06% to 4.87%, five-year yields rose from 3.60% to 4.13%, 10-year yields rose from 3.48% to 3.81% and 30-year yields rose from 3.67% to 3.85%.

What happened in the Fund?

The Fund was down 0.12% during the June quarter. Within the Fund, duration and yield-curve positioning was the most significant detractor on a net basis as a result of overall long U.S. duration positioning over the quarter. Emerging markets (EM) debt was the most significant contributor to performance as most Russian local currency government bonds began trading again and were marked up in price, but local currency sovereign exposures in Brazil, Mexico, Indonesia, India and Poland were also beneficial. High-yield exposures contributed positively over the quarter, driven mainly by energy and consumer cyclicals, as did investment-grade credit, which was driven mainly by exposures to financials, energy and consumer non cyclicals. Overall foreign exchange (FX) positioning detracted from performance on a net basis. The negative contribution from developed market (DM) FX was driven mainly by Japanese yen exposure, while the positive contribution from EM FX was driven mainly by Mexican peso exposure. Mortgage- and asset backed securities (MBS/ABS) were a positive contributor over the quarter, driven mainly by exposures to collateralized mortgage obligations (CLOs).

From a positioning standpoint, the Funds headline duration increased by a little more than a year as inflation pressures eased, quarterly economic data were solid and the labour market remained resilient. As short rates adjusted higher, some duration was moved from longer maturities into front-end steepeners. Although this part of the yield curve is now inverted due to expected further tightening, even with additional rate hikes we believe the curve will steepen as both growth and inflation continue to decline. The position also enjoys an element of “risk-off” protection as unforeseen shocks to the market would also likely cause a steepening. Long-dated duration is positioned with a flattening bias. Long Japanese yen exposure increased as the currency traded weaker versus the U.S. dollar based on the view that pressure is building for Bank of Japan Governor Ueda to loosen yield-curve control bands. The long Australian dollar position increased based on our positive outlook for China and was helped by a surprise hike by the Reserve Bank of Australia. Cuts were made to long euro exposure as the eurozone continues to feel pressure from further ECB hawkishness. In EM FX, profits were taken on long Mexican peso and rotated into long Brazilian real, as both currencies offer quite positive carry. Investment-grade credit exposure decreased as spreads tightened on stronger economic data.

What is the outlook?

In line with our expectations, global growth is downshifting and the disinflation process is clearly underway, albeit unevenly. Lessening bottleneck pressures, financial stability concerns contributing to tighter credit conditions in the U.S. and Europe, and softer manufacturing and services demand worldwide are helping to alleviate price pressures globally. These trends, combined with the major central banks continuing to advocate for restrictive monetary policy for an extended period, should further temper growth and inflation. In such a scenario, we expect DM government bond yields to trend lower and that the U.S. dollar will weaken modestly. These factors should act as a tailwind for EM where central banks are closer to the end of the tightening cycle relative to the developed world, and valuations are attractive. Spread sectors such as high-yield, bank loans and select areas of the MBS space also offer attractive yield, but we acknowledge that credit markets remain vulnerable to unanticipated shifts in macro related sentiment, geopolitical developments and the risk of central bank overtightening.

Past performance is not a reliable indicator of future performance.

Highlights

- The Fund invests in a concentrated portfolio of investment grade and high yielding debt securities, and derivatives.
- A professionally managed unconstrained portfolio, focused on identifying attractive investments caused by market dislocation.
- The Fund is designed to potentially have a low correlation to equities and traditional fixed income over the long term.

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.

Western Asset

Founded in 1971, Western Asset is one of the world's leading fixed income managers. With a primary focus on active fixed income investment management, the firm brings unique value to the asset class with a time-tested, value-oriented investment approach. This approach is supported by an international team of fixed income specialists with expertise in every market sector, including an extensive credit research team experienced in evaluating companies across the entire ratings spectrum. Western Asset's reach extends across all of the world's major bond markets with offices in Pasadena, New York, London, Zürich, Tokyo, Singapore, Hong Kong, Melbourne, and São Paulo.

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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