

Western Asset Macro Opportunities Bond Fund

Sep 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)	-7.59	-7.26	0.11	-7.82	-1.57

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 third quarter of 2023, global government bond yields rose to multi-year highs. Continued U.S. economic resilience as well as higher policy rate expectations from Federal Open Market Committee (FOMC) members revived a “higher-for-longer” narrative for global policy rates. A confluence of additional factors put further upward pressure on yields: Fitch’s downgrade of long-term U.S. debt to AA+, a higher-than-expected U.S. Treasury (UST) issuance announcement, as well as a surge in energy prices that stoked inflation concerns. Heightened uncertainty over long-run interest rates raised global term premiums and steepened global government bond yield curves. A moderating outlook for both employment and inflation ultimately set the stage for the Federal Reserve (“Fed”) to leave the fed funds target rate unchanged at 5.25%-5.50% in September, following the 25-basis point (bp) hike in July—its second rate pause since the current tightening cycle began in March 2022. However, in what was interpreted by markets as a sign of “higher-for-longer” policy rates, the updated Summary of Economic Projections in September showed Fed officials anticipate less easing over the next two years. Compared to June, the median FOMC member raised projections for the fed funds target rate by 50 bps to 5.10% and 3.90% at the end of 2024 and 2025, respectively—reflecting a strong growth outlook and in spite of a projected moderation in inflation. Projections for 2023 real gross domestic product (GDP) growth were raised to 2.1% from 1.0%, while forecasts for the unemployment rate were revised lower through 2025. Core Personal Consumption Expenditures Price Index inflation was projected to end the year lower at 3.7% from 3.9% previously and reach the Fed’s 2% target in 2026. In contrast to the U.S., the economic growth trajectory for Europe remains challenged. The European Central Bank (ECB) hiked the Deposit Facility rates by 25 bps on two separate occasions, bringing it to 4.00%. The policy statement from the September meeting highlighted that the current level of monetary policy will make a “significant contribution” to bringing inflation back to target. During the quarter, corporate credit and structured product spreads were flat to modestly wider. U.S. dollar-denominated emerging market (EM) bond spreads tightened and EM local yields rose. The S&P 500 fell 5.0% while WTI oil surged 28% to just above \$90/barrel. A relatively resilient U.S. economy pushed the U.S. dollar stronger versus EM and developed market (DM) currencies.

What happened in the Fund?

The Fund was down 7.26% during the September quarter. Within the Fund, duration and yield-curve positioning was the most significant detractor on a net basis mainly as a result of overall long U.S. duration positioning over the quarter. EM debt was also a significant detractor mainly due to Mexican local currency sovereign exposures, but exposures in Brazil and Russia also detracted from performance. Overall foreign exchange (FX) positioning detracted from performance on a net basis. The negative contribution from EM FX was driven mainly by Russian ruble exposure, but long Indian rupee, South Korean won, Indonesian rupiah, Mexican peso and Brazilian real exposures also detracted. Within DM FX, exposures to the Australian dollar and Japanese yen were detractors, but the positive impact from short euro and British pound exposures offset some of the negative performance. Investment-grade credit contributed positively over the quarter, driven mainly by exposures to energy, financials, consumer non-cyclicals and consumer cyclicals, as did high-yield credit, which was driven mainly by energy and communications exposures. Mortgage and asset-backed securities (MBS/ABS) were also a positive contributor over the quarter, driven mainly by exposure to collateralized loan obligations.

From a positioning standpoint, during the quarter headline duration decreased by approximately 1.5 years. In the U.S., we sold more duration in the 5- to 10-year part of the UST curve to add to 2-year UST futures (with the view that the large central banks are close to finishing their rate-hiking cycles) as well as to longer maturities, which provide portfolio balance in times of market distress. In global duration, we rotated about 0.5 year out of the very front end of the U.K. Treasury curve with the view that there was more limited upside left in the position. Similarly, we rotated out of the very front end of the German rates curve and added about 2.25 years to the longer end, which now shows more upside potential, and with the view that the ECB is closer to finishing its rate-hiking cycle than is the Fed, and the EU and U.K. have a higher probability of recession than the U.S. In credit, we reduced investment-grade exposure mainly via industrial names, which have not all followed commodities lower, while adding beta via high-yield credit default swap index (CDX) exposure in the case that risk asset prices reverse and move higher.

What is the outlook?

As we anticipated, global growth has downshifted and inflation rates worldwide are generally receding. Tightening financial conditions in the U.S. and Europe, weaker demand for manufacturing and services across a number of countries, and deflationary pressures in China are easing price pressures globally. These trends, coupled with the major central banks advocating for a prolonged period of restrictive monetary policy, are expected to further dampen economic growth and inflation, which, in turn, should lead to lower DM government bond yields and a modestly weaker U.S. dollar. That stated, concerns over a “higher-for-longer” rate environment driven by factors such as stronger-than-expected growth in the U.S., increased UST supply to cover a growing fiscal deficit, and inflation remaining above respective central bank targets may lead to periods of heightened market volatility. Spread sectors such as EM, high-yield, bank loans and select areas of the MBS space offer attractive yield, but we acknowledge their vulnerability to unanticipated shifts in macro-related sentiment, geopolitical developments and the ongoing risk of central bank overtightening.

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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