Nedgroup Investments Global Strategic Bond Fund

Core, Nimble, Proven

If tightrope walking were an Olympic sport, my fear of heights and poor balance would not land me a podium position. Markets in August were just as shaky, teetering on the edge of fear after a long dance between fear and greed.

Alex Ralph
Co-portfolio Manager

David Roberts
Co-portfolio Manager

Performance and markets

Low trading volume, holiday season for Northern Hemisphere investors, and a supercharged market set the stage for volatility. Before turning to bonds, a few weeks ago we saw Bitcoin plunge 20% in a session and the Nikkei fall 10% (saved by the circuit breaker) as the “yen carry” trade unwound after the Bank of Japan rate hike – possibly the best-flagged mini-crash in history!

Returns to (%, US$)	Fund[1]	Index[2]
Aug 24	1.01%	1.10%
Since inception	5.10%	3.88%

Bond yields fell, pricing in over 10 US rate cuts in the next 18 months and a terminal rate below 3%. Proper recessionary stuff. Despite the thin market, most equity and alternative losses were quickly reversed, and yields rose. However, they remained lower in most jurisdictions during August, making it another positive month for returns, building on July’s strength. Corporate debt was similarly volatile, falling then regaining much of its lost value. Liquidity was thin for once, so we were generally happy to avoid the secondary market.

Key performance drivers

The following is based on estimated top-down absolute contribution.

Total excess return for the month: -10bps		
Contribution		**Positioning comments**
Duration	**-30bps**	• Long Western markets and 1.5 years shorter than the index. • No Japan and the flash crash meant yields fell on the month albeit less than in the US
Curve	**+5bps**	• Steepening continued which was positive despite reducing position.
Geography	**+10bps**	• No Japan (attributed to duration). • Canada and Australia lagged. • US led.
Asset allocation	**0 bps**	• Credit spreads remained solid overall. • Modest widening offset carry a little.
Credit sector/ security selection:	**+5bps**	• Steepening credit curves drove short-dated outperformance. • Defensives marginally outperformed.

Positioning recap and outlook

Total portfolio: Yield = 5.1% (% exc. futures), Duration = 5.3 years, ESG rating: A

Rates (weight = 30.6% (40.6% inc. futures), yield = 4.6%, duration = 3.0 years)

Positioning in sovereign bonds	**Fund**	**Expected fund range**	**Index**
	30.6%	**30 - 40%**	**53%**
Investment perspectives	**Valuations**[3] 4-5 US rate cuts by year end, slightly less in EU and UK (and Japan hikes largely priced out) mean valuations are "full" short term.	**Fundamentals** Despite the volatility and rate rally, economic numbers have been solid. For once, Germany is the exception.	**Technicals** August was a thin month. Demand for credit remained robust, figures suggest some $35billion inflow to EU bond funds.

- US and Japan led the way to lower yields. UK lagged badly.
- For Western markets it was all about economics – UK economic strength impacted gilt prices.
- Mixed messaging in response to Yen/Nikkei turbulence from the Bank of Japan kept yields lower.
- We used the opportunity to short Australia and add to the Canada short. Both worked in our favour.

Credit (IG: weight = 54.2%, yield= 5.0%, duration = 4.7 years)
(HY: weight = 14.1%, yield= 6.6%, duration = 2.7 years)

Positioning in credit	**Fund**	**Expected fund range**	**Index**
	Investment grade: 54.2%	**20-60%**	**19%***
	High yield: 14.1%	**20-30%**	**0%**
Investment perspectives	**Valuations** After a brief wobble, valuations remain expensive, with A/BBB spread back to its tightest in 10 years. Some cyclical premia has begun to be priced in.	**Fundamentals** Solid fundamentals remain but European cyclicals are suffering from margin compression with one of the longest manufacturing recessions in living memory.	**Technicals** Technicals remain strong, However, demand has operated on a 4-6 week lag. Lower all in yields may potentially dampen demand at a time that supply picks up.

*"Pure" IG credit. Add in Structured, Agency and EM and the index has 47%

- US investment grade underperformed in the sell-off, creating an opportunity to switch into US credit tactically. The underperformance was brief however, and we remain strategically long Europe.
- The rapid pull back in spreads at the beginning of August was short lived. With very little liquidity, it was dealers marking spreads wider rather than any significant selling.

Portfolio changes and where next

We doubt September will be as volatile as early August. As we approach the the US election and understand each candidate's economic policy, markets should stabilise. However, macro data has been good and if we start to see rate cuts priced out this could see a further bout of risk aversion. And of course either candidate could surprise negatively.

Rates markets do need a run of soft data to justify current levels. Longer term, we remain confident that 4% in either US or UK ten year bonds should be a great real return entry point for investors. Short term, we see little to stop bonds moving above that level and if so, we will likely add – assuming the reason for the shift is momentum-driven rather than data driven

Credit's recovery from early August lows has been impressive, showing huge demand for the asset class. Prices are fine for a benign economic environment, especially as investors take profits from tech stocks and shift into income generating corporate debt. We remain cautious that little is priced in for mishaps.

What to watch out for next month

Rates: Can sovereign markets sustain current positioning without softer economic data? The disconnect between market and central banks is almost as big as December 2023. Will Harris and Trump show their macro hand?	**Credit:** Supply is set to pick up in September. With all in yields relatively low, will demand for credit match expected supply? New issue discounts may have to improve to entice credit investors.

Contribution and positioning information as at 31 August 2024. Yield shown is yield to worst. Source: Nedgroup Investments

1 Fund returns are in US$ based on Class D Accumulation. Source: Morningstar

2 Index returns in US$ based on Bloomberg Global Aggregate Total Return Index (hedged to US$). Source: Morningstar

3 Valuations are based on a medium-term outlook. For government bonds, this is determined by market returns (beta) relative to inflation/inflation expectations and real growth. For corporates, this is determined by adjusting expected excess returns for risk (default and volatility). Valuation based strategic positioning may be adjusted for shorter term technical or fundamental economic factors.

Contact us

Email: Clientsolutions@nedgroupinvestments.com

London: 7th Floor, 12 Arthur Street, EC4R 9AB, +44 (0) 7960 901396

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