Nedgroup Investments Global Strategic Bond Fund

Core, Nimble, Proven

July was all about the rates market. Government bond yields went down faster than an Olympic triathlete exiting the Seine and markets refocused their attention on economic data. US inflation softened, opening the door to interest rate cuts in the fourth quarter and government bond curves duly steepened.

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Performance and markets

Whilst most of July saw both rates and credit trade in a fairly narrow range, the last few days markets came alive with a large move down in government bond yields. Up until the last week, most of the activity was focused on curve steepening – predominately driven by concerns over the US fiscal deficit as electioneering highlighted the black hole in funding by both parties. Bond yields finally broke out of their recent ranges as weaker inflation and job market data reinforced a Fed cut narrative. In contrast, Japan increased interest rates by 25bps in attempt to normalise monetary policy despite a run of poor economic data.

Returns to (%, US$)	Fund[1]	Index[2]
July 24	2.06%	1.91%
Since Inception	4.05%	2.79%

A cautious market mood on the back of geo-political tensions in the middle east and weakening economic data did little to move credit spreads. There was outperformance from European investment grade with marginal spread tightening. US spreads held steady with defensive higher rated credits outperforming.

Key performance drivers

The following is based on estimated top-down attribution analysis.

Total excess return for the month: +15bps		
Contribution		**Positioning comments**
Duration	**-10bps**	• Overall less duration than index, but fully invested in short-dated bonds.
Curve	**+15bps**	• Steepening curves helped relative performance.
Geography	**+5bps**	• Avoided Europe (except Germany) and Japan, both of which lagged.
Asset allocation	**0 bps**	• Credit spreads remained solid.
Credit sector/ security selection:	**+5bps**	• O/W Europe vs U.S. improved excess returns as European investment grade spreads tightened whilst US held steady. • Defensives marginally outperformed.

Positioning recap and outlook

Total portfolio: Yield = 5.2% (% exc. Futures), Duration = 4.9 years, ESG rating: A

Rates (weight = 29.4% (32.7% inc. Futures), yield = 4.75%, duration = 3.6 years)

Positioning in sovereign bonds	**Fund**	**Expected fund range**	**Index**
	29.4%	**30 - 40%**	**53%**
Investment perspectives	**Valuations[3]** Back to pricing 2-3 rates cuts – need to expect a recession for more to be justified	**Fundamentals** Fair – G7 growth is slowing, although inflation remains sticky	**Technicals** Surveys suggest some adding, however there has been a lot of cash for the market so it might be investors are maintaining not chasing

- US, UK and German 10-year yields fell around 15bp on the month, softish data encouraging bond bulls.
- We had started to see a risk-off rotation early in July that impacted France and Italy sovereign debt, neither of which we owned.
- We continued to avoid Japan where yields jumped higher following the Bank of Japan's decision to raise interest rates.
- Australian bonds continued to recover, we reduced our recently added long position, trimming the long standing short in Canada as the yield between the respective bonds fell around 15basis points.

Credit (IG: weight = 52.6%, yield= 5.4%, duration = 4.7 years)
(HY: weight = 14.5%, yield= 7.0%, duration = 2.8 years)

Positioning in credit	**Fund**	**Expected fund range**	**Index**
	Investment grade: 52.6%	**20-60%**	**19%***
	High yield: 14.5%	**20-30%**	**0%**
Investment perspectives	**Valuations[3]** Remains expensive but US credit is starting to become relatively attractive.	**Fundamentals** Good but slowly weakening as interest coverage deteriorates.	**Technicals** Demand remains strong and pace of supply abates.

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

- US investment grade began to show signs of weakness. Whilst overall spreads remained steady, BBB cyclicals widened. We cut our industrial exposure in Europe before the weakness spilt over to other markets.
- Taking profits in PVH and trading into Burberry on a large spread pick up was taken too soon.
- Our overweight in European credit helped overall performance.
- The fund benefited from individual high yield positions such as Kier group, rallying on a labour government election.

Portfolio changes and where next

Within the last few days of the month, markets have been focused on weakening economic data in the US. The question is whether fundamentals begin to dominate or political uncertainty asserts itself once more. Whichever it is, a steepening of the yield curve looks set to continue. Deteriorating US jobs market would see short-term rates fall and the latter could see long-end suffer under funding concerns. Differing economic backdrops will also continue to provide opportunity over the medium term. Momentum to the UK economy should ensure UK/US yield differentials compress further. Finally, credit has remained remarkably resilient throughout the year. Whilst fundamentals justify that resilience to a certain extent, markets can only maintain differing outlooks for so long. We expect credit markets to begin pricing in a US slowdown at some point, whilst we await that move, we will continue to invest for carry with a defensive bias.

What to watch out for next month

Rates: How will markets react to slightly softer data, given rates are at the lower end of 6-month ranges? Central banks seem reluctant to cut aggressively - will markets react as they did a year ago and price in too many cuts?	**Credit:** Any significant underperformance of US credit could provide us with an opportunity to switch out of our European overweight. We await to see if credit markets begin to price in a slowdown.

Attribution analysis and positioning information as at 31 July 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.

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