ERIC STURDZA INVESTMENTS

# Strategic Bond Opportunities Fund

August 2019 Fund Commentary

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PORTFOLIO MANAGER

## MARKET DEVELOPMENT

In August, the US Treasury bond curve rallied, with long-dated bond yields plummeting due to increasing uncertainties such as the trade war, demonstrations in Hong-Kong, a no-deal Brexit and the political turmoil in Italy. Central banks continued to deliver very dovish messages, with rate cuts anticipated from both sides of the Atlantic. Due to weak inflation and recession fears in Germany and Italy, the ECB is expected to implement an aggressive monetary policy programme including a rate cut and another wave of Quantitative Easing in September. As a result, the Fed came under pressure (from both, Wall Street and the White House) as a stronger dollar against the euro is another important reason to ease US monetary policy in an attempt to avoid a recession or – at least – a significant slowdown of the US economy over the coming months.

## PORTFOLIO STRATEGY

In August, the Investment Adviser slightly increased the portfolio's duration by selling $1.5 million 30y US Treasuries (nominal yields) and buying $3 million 30y TIPS (inflation-linked US treasuries, real yields). The team also invested some cash in 1y US Treasury.

## MARKET OUTLOOK

The Investment Adviser's outlook is tied to two major topics, the macroeconomic situation (including growth and inflation) and Central Banks' behaviour. Inflation risk remains subdued in the US and substantially below the ECB's target in the Eurozone. Globally, growth is lower (mainly in China and Germany, possibly in the UK depending on the Brexit outcome) except for in the US, with the domestic economy remaining robust for the time being. This said, markets and central banks are aware that this safe haven position is temporary. Yield curves may continue to flatten and the US curve invert on increasing fears of a significant global growth slowdown, which will impact the domestic economy.

In the US market, the Investment Adviser believes that long term US Treasuries are still attractive and is considering increasing the portfolio's duration against escalating global trade tensions and recession fears. Contemplating the current inflation expectations, and should they reach depressed levels, the team intends to further increase exposure to US inflation-protected securities, which were initiated in August.

According to the Investment Adviser, a further inverted US curve slope is still not excluded in the short term, with markets being concerned that the Fed may stay behind the curve. The team think that the best strategy today is to continue investing in a timely manner, keeping a selection of short-term high quality corporate bonds and investment grade emerging market bonds, combined with a barbell strategy on the US Treasury yield curve, with an overweight of 1-2y, combined with long dated US Treasuries (both nominal and real yields).

The Fed has recently delivered its first rate cut since the financial crisis and the FOMC may be forced to implement additional rate cuts should global growth continue to weaken, trade tensions remain and the dollar strength persist. In this context, the Investment Adviser believes that the Fed will continue to ease its monetary policy before year end or even implement a QE4 at some point.

### INVESTMENT APPROACH

The Fund is a diversified bond fund, investing in bonds predominantly denominated in USD, including Sovereigns, Supranationals and Agencies (together SSAs), corporate bonds across all sectors and financials. A strong conviction portfolio of 30-60 issuers, seeking exposure to all continents (including developed as well as emerging markets), all types of ratings from AAA/Aaa to BB/Ba2 (Standard & Poor's/Moody's) and non-rated bonds (10% maximum), senior or subordinated debt (hybrid corporates and Tier II bank debt) with either fixed or floating coupon rates.

### INVESTMENT OBJECTIVE

To achieve a total return through a combination of capital growth and income by investing in a globally diversified portfolio of fixed income securities.

A sub-fund of E.I. Sturdza plc. Registered in Ireland.

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In Europe, the team believe that current macro conditions and Brexit uncertainties support new accommodative measures from the ECB. An easing package will be unveiled in September, with a cut in the deposit rate and a new QE program (potentially more aggressive than expected due to weaker inflation and growth).

In Emerging Markets (EM), the Investment Adviser will continue to closely monitor the spread patterns (both governments and corporates) and EM countries' ability to absorb trade shocks in the context of weak FX and a broad commodity market which is under pressure.

In conclusion, the Investment Adviser still believes that the best performing asset class is a mix of high-quality short term Investment Grade bonds (USD denominated corporates and emerging markets) combined with long-term US Treasuries. This said and given the current environment of a global spread-widening risk, the team may continue to increase the weight of US Treasuries, whilst reducing exposure to the three other pillars (corporate spreads in dollars, emerging markets in dollars and corporate spreads in euro).

The team believe that a mix of high grade corporate carry and US Treasuries will represent an opportunity to deliver robust performance during the coming months, despite a very low yield environment and a strong performance since the inception of the Fund.

## IMPORTANT INFORMATION

The views and statements contained herein are those of the Eric Sturdza Group in their capacity as Investment Advisers to the Funds as of 12/09/2019 and are based on internal research and modelling.

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