Strategic Bond Opportunities Fund

September 2019 Fund Commentary

MARKET DEVELOPMENT

In September, the fixed income markets (US and Eurozone) experienced a significant correction during the first half of the month before stabilising during the second half. According to the Investment Adviser three geopolitical events triggered investors to favour riskier assets to the detriment of safe havens: a lower risk of tensions in Hong Kong, a new government in Italy and the defeat of Boris Johnson which opened the door to a "not-too-hard" Brexit. At the same time, the unemployment figures in the US were broadly stable, with average hourly earnings (wage inflation) having increased slightly.

The ECB meeting on 12th September showed that the situation is worrisome in the Eurozone as inflation is still very low (and could stay weak until at least 2022). Additionally a recession in Germany's manufacturing sector which accounts for more than 20% of its GDP (compared to 12-15% in other countries) is hurting the country. The decisions taken (deposit rate lowered to -0.5% and restart of QE) were largely expected but the debates were far from the traditional consensus and unanimity. Finally, Mr Draghi mentioned that the ECB has done the job and can't do a lot more, calling on governments to take their responsibilities and implement large scale fiscal stimulus measures.

On 18th September, the FOMC delivered an ambiguous message. The rate cut was expected but Mr Powell did not really open the door to another cut before year end. More importantly, the Fed was under pressure regarding its management of the money market crisis. The overnight repo market spiked (reaching 10% for a few minutes), threatening the development of the whole money market denoted in US dollars. Mr Powell confirmed that the situation was kept under control through injections of $75 billion per day and that the Fed has a lot of tools to fix the problem. As a consequence, money markets returned to previous levels. This said, the investment team believe that this incident is a consequence of the quantitative tightening policy followed by the Fed during the first half of the month. In order to fix the damage in the medium-long term, the US central bank is obliged to increase the size of its balance sheet with a QE4 "for technical reasons only".

In this difficult and volatile environment (Aramco rigs characterised by the attacks in Saudi Arabia, the ongoing and impeding trade war, impeachment…) US yields finished the month at a higher level than in August, which the Investment Adviser believes is a pause in the bull market, rather than the beginning of a bear market.

PORTFOLIO STRATEGY

In September, the Investment Adviser slightly increased the portfolio's duration, adding 30y Treasuries (both nominal and real yield TIPS) during the correction. The team also switched a small position from Treasury 2024 into the new 10y benchmark maturing in 2029. In terms of the short maturity Investment Grade market, they bought two new bonds, maturing in 2021 and 2022, both AA-rated issues closely linked to the Singapore government.

MARKET OUTLOOK

The Investment Adviser's outlook remains tied to two major behaviours, 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. Growth is

Eric Vanraes
PORTFOLIO MANAGER

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.

CONTACT

E.I. Sturdza Strategic Management Limited

+44 1481 722 322
info@ericsturdza.com
ericsturdza.com

lower (mainly in China and Germany, possibly in the UK depending on the Brexit issue) except in the US for the time being, where the domestic economy remains robust, with markets and central banks however being aware that this safe haven position is temporary. The team believes that yield curves may continue to flatten, increasing fears of a significant global growth slowdown spreading into the domestic economy.

In the US market, the Investment Adviser believes that long term US Treasuries are still attractive and may increase duration against escalating global trade tensions, recession fears and the implementation of QE4. Considering inflation expectations, the team will maintain a significant exposure to US inflation protection securities initiated in August and September.

According to the Investment Advisers a flatter 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 thinks that the best strategy today is to invest in a timely manner, maintaining a selection of short term high quality corporate bonds and investment grade emerging markets 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 delivered its first two rate cuts since the financial crisis and the FOMC may be forced to implement more 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 monetary policy before year end and increase its QE4 at some point if needed.

In Europe, the Investment Adviser thinks that current macro conditions and Brexit uncertainties support the recent accommodation measures from the ECB. After the decisions taken in September, the team believe that monetary policy should be less aggressive, with central bankers probably asking some major governments to implement a common fiscal stimulus policy (but they first need to provide the German Government with enough convincing evidence). In the Investment Adviser's view, the ultra-accommodative monetary policy (negative rates in particular) has probably reached its limits.

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

In conclusion, the team 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 Investment Adviser 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 believes that a mix of High Grade corporate carry and US Treasuries will present an opportunity to deliver a robust performance in the coming months; despite a very low yield environment and an already strong performance delivered by the fund since inception.

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 11/10/2019 and are based on internal research and modelling.

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