Strategic Bond Opportunities Fund

October 2019 Fund Commentary

MARKET DEVELOPMENT

In October, the US fixed income market experienced a rally at the beginning of the month after the publication of weaker than expected ISM indices (Institute for Supply Management). The Manufacturing sector has entered a recession but the Service sector has also declined. The unemployment figures showed a contrast between a record low unemployment rate, 3.5%, not seen since 1969, and average hourly earnings at 0%, revealing a +2.9% YoY increase instead of +3.2%.

After a bullish market during the first week of the month, US bonds started to correct off the back of better news regarding trade talks between the Chinese and Americans and on Brexit. At the same time, the Fed implemented its "non-QE", buying short-term bills and bonds in order to stabilize the repo market. The US central bank is supposed to purchase around $200 billion through to year-end, growing its balance sheet to $4.2 trillion. Despite Jerome Powell's efforts to convince the markets that these purchases are just technical adjustments and have nothing to do with a QE, markets stayed sceptical and worried about the real situation of the repo market.

Meanwhile, as the deadline for Brexit being postponed until 31st January approached and the prospect of a first trade deal between the US and China being concluded before mid-November, fears of a global slowdown decreased sharply. Equity markets performed well to the detriment of safe havens such as long term bonds or gold. As expected, the Fed cut its rates for the third time this year but signalled a possible pause. The odds of the "status quo" being retained at the next FOMC meetings on the 11th December increased to 89%, meaning the next possible rate cut cannot occur until the 29th April 2020.

In Europe, Mario Draghi left the ECB, replaced by Christine Lagarde. Both have stated that the Central Bank has done its job and governments should help with a coordinated fiscal and budget policy. Many officials thanked Mr Draghi for his tremendous role, his famous statement, "whatever it takes", having probably saved the euro in July 2012 in the Investment Adviser's opinion.

PORTFOLIO STRATEGY

In October, the team increased exposure to short maturity Investment Grade issues with the purchases of NY Life, Toyota, EDP and Barclays, whilst taking profit on Metro de Lima and increased exposure to US Treasury 2029.

MARKET OUTLOOK

The Investment Adviser's outlook continues to be tied to two major themes, the macroeconomic situation (including growth and inflation) and Central Banks' behavior. Inflation risk remains subdued in US and substantially below the ECB's target in the Eurozone. Growth is lower (mainly in China and Germany, possibly in the UK depending on the consequences of Brexit) 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 flatten, increasing fears of a significant global growth slowdown spreading into the domestic economy. In the short term, the US yield curve could steepen due to the Fed's purchases in the short term

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**.**

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US bills and notes markets in order to increase the size of its balance sheet and fix the turmoil in the repo market.

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 the 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 Adviser, a flatter US yield curve slope is still not excluded in the mid term, with markets being concerned that the Fed may stay behind the curve. The team believe 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 with regards to 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 three 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 persists. In this context, the Investment Adviser believes that the Fed will continue to ease its monetary policy in the coming months and increase its QE4 at some point if needed.

In Europe, the Investment Adviser believe 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 the monetary policy should be less aggressive, with central bankers asking some major governments to implement a common fiscal stimulus policy. The first objective of Christine Lagarde will be 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 spreads (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 will be 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 and the risk that spreads will widen globally, 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 robust performance in the coming months; despite a very low yield environment and the 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 12/11/2019 and are based on internal research and modelling.

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