Strategic Bond Opportunities Fund

January 2020 Fund Commentary

MARKET DEVELOPMENT

In January, safe haven government bonds retraced most of their Q4 2019 correction as fears over a coronavirus pandemic grew. Concerns over its impact on global growth lead to a yield curve flattening and even a partial inversion, the 3mth/10yr closing the month at -3 basis points. In this context, the US fixed income market rallied strongly, the 10yr yield declining from 1.92% to 1.5% (-41bp) during the month. Despite this safe haven bid, Investment Grade credit markets remained stable, US CDX IG and iTraxx Main increasing by only 5bp (50) and 2bp (46) respectively. Unlike Investment Grade, the High Yield segment underperformed due to increased volatility in some of its highly leveraged sectors and lack of duration exposure. Following a 2.1% annualised growth rate in Q4 19, the US economy expanded 2.3% in 2019, its slowest pace since 2016. Consumption and business investment have shown signs of moderation during the last quarter and the labour market remained firm without any notable wage inflation. The first FOMC of the year came with no rate hike as expected. Despite members agreeing for a status quo based on current economic activity, Fed Chairman J. Powell recognised that the coronavirus poses a downside risk to the global economy.

In Europe, the economy expanded by 0.1% in Q4 19, despite France and Italy's growth unexpectedly contracting by 0.1% and 0.3% respectively. With post-Brexit uncertainty and the ongoing global trade tensions, the new ECB President Christine Lagarde left the deposit rate unchanged at -0.5%. The ECB launched its first strategic review which will be extended not only to inflation and employment, but also to environmental sustainability goals.

In the UK, the BoE also left its rate unchanged at 0.75%, despite expectations of a 25bp rate cut, and downgraded its growth forecast for the next 2 years. Despite a strong job market, consumption figures failed to rebound in recent months and with Brexit and future trade deals uncertain, rate cut expectations have increased for the second half of 2020.

PORTFOLIO STRATEGY

In January, the Investment Adviser actively managed the portfolio's credit exposure and duration. The main strategic decision of the month was to decrease the Fund's exposure to Emerging markets, predominantly in Asian credit (China, Hong Kong, Korea and Indonesia) and to issuers exposed to the Energy sector. At the same time, the Team started to build positions in defensive issuers within the EUR Hybrid universe hedged in USD for their carry, and risk reward profile which remains attractive. With the growing coronavirus fears, the Investment Adviser increased exposure to the long end of the US Treasury curve by purchasing nominal bonds maturing in 2029 and 2049, while keeping the 30y TIPS exposure unchanged on concerns of global growth contraction in the coming months. As a result, the portfolio's modified duration increased from 3.7 to 4.8 at the end of the month.

MARKET OUTLOOK

The Investment Adviser's outlook remains focused on two major topics; the macroeconomic situation (including growth and inflation) and Central Banks' behavior. Inflation risk remains contained in the US and substantially below the ECB's target in the Eurozone. Growth is expected to contract in the coming months as China may face a significant slowdown, with consequences not only for the Eurozone but also for the US, where despite the domestic economy remaining robust (consumption, labor market), capital investment outlook has continued to deteriorate notably in the most sensitive industry sectors. For now, markets anticipate the situation to be temporary and central banks to remain proactive in order to

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

avoid any financial crisis. In the short term, the US yield curve could continue to flatten due to strong demand for safe haven assets, particularly US Treasuries, with the Fed's purchases in the short term US bills and notes markets continuing in order to increase the size of its balance sheet and fix the turmoil in the repo market.

In this context, the Investment Adviser believes that long term US Treasuries are still attractive and may increase duration against escalating global trade tensions and recession fears, in case the impact of coronavirus on global growth is more severe. Considering inflation expectations, the Team will maintain a significant exposure to US inflation protection securities, falling breakeven expectations having been limited for now. The Team believe that the best strategy today is to invest in a timely manner, maintaining exposure to a selection of high quality corporate 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). Facing potential risk on growth and global trade, the Investment Adviser believes that the probability of a rate cut will remain high, with a 25bp drop in Fed funds already expected at the end of the second quarter 2020 and additional cuts expected during the rest of the year. In this context, the Investment Adviser believes that the Fed, after a probable pause during the first quarter, 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 is of the opinion that current macro conditions, Brexit uncertainties and the recent coronavirus outbreak support the accommodation measures recently introduced by the ECB. In the Investment Adviser's opinion, the ultra-accommodative monetary policy (negative rates in particular) has probably reached its limits and implementation by some major governments of a common fiscal policy may kick in sooner rather than later. Moreover, in the current ECB policy review, environmental sustainability goals could have an impact on its Corporate Sector Purchase Programme (CSPP).

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 the broader commodity market, which remains under pressure. The coronavirus outbreak should initially weigh on countries with very close economic ties to China.

In conclusion, the Team still believe that the best performing asset class is likely to be a mix of high quality credit corporate bonds from Investment Grade and Hybrid issuers (in USD and Euro hedged in USD) combined with long term US Treasuries. This said, and given the current environment of potential spread widening risk, the Investment Adviser may continue to increase the weight of US Treasuries, whilst reducing exposure to the three other pillars. The Team believe that a mix of High quality companies corporate bonds 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.

PERFORMANCE DATA As at end of January 2020

CUMULATIVE PERFORMANCE %

	1M	3M	1Y	Fund Inception
USD I	1.26	0.91	7.70	9.33
Composite Benchmark	1.23	1.18	6.17	7.44

CALENDAR YEAR PERFORMANCE %

	YTD 2020	2019	Annualised Inception
USD I	1.26	7.47	8.19
Composite Benchmark	1.23	5.57	6.54

Past performance is not an indicator of future performance.

IMPORTANT INFORMATION

The views and statements contained herein are those of Banque Eric Sturdza SA in their capacity as Investment Advisers to the Funds as of 13/02/2020 and are based on internal research and modelling.

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