Strategic Bond Opportunities Fund

February 2021 Fund Commentary

Market Development

During February, the markets continued to fear more inflation pressures than expected at the end of 2020. In addition, two factors triggered the beginning of a significant sell-off in the US Treasury market, long bonds in particular.

The first factor was the beginning of a series of poorly supported auctions due to a lack of demand and a huge amount of debt issued for 2021. The second event was the behaviour of the Fed and Chair, Jerome Powell. The US central bank confirmed that, despite a probable surge of inflation in the coming quarters, there is no long-term inflation risk, implying that there are no changes expected in the monetary policy in the short term.

The markets thought (and still think) differently however, and this attitude added more fears and uncertainties, prompting the likelihood of a Fed "behind the curve". As a result, 10y and 30y Treasury yields increased sharply during the month. Very high-quality credits (i.e. AA and A rated) were less affected, but were not immune to this correction due to very tight spreads. In Europe, Bond yields increased despite a very different situation, putting the ECB on the spot.

Market Outlook

Our outlook is still focused on the macroeconomic situation (including growth and inflation), Central Banks' behaviour and the evolution of equity markets. At the same time, the COVID-19 pandemic spreading in Europe and not decreasing in the US continues to be a major concern despite the arrival of the vaccines (which has been offset by the appearance of different variants).

Inflation fears are another significant concern, but the reaction of the market, with the Treasury sell-off, is probably exaggerated. We, like the Fed, believe that consumer prices will increase (possibly sharply) during the coming months but inflation should come down in Q3. Global growth is expected to increase gradually in the coming months in Asia, Europe and the US should the COVID-19 crisis decrease gradually.

In the US, the Treasury yield curve could continue to steepen, but Fed purchases and strong demand for safe haven assets should stabilise long-term yields at current levels. We are not excluding a continuation of the sell-off, but should long-term yields reach higher levels, such as 1.75% for the 10y and 2.5% for the 30y, this could become a buying opportunity. However, following the sharp increase of inflation breakevens, it's our belief that any exposure to US inflation protection securities has become too risky. As a result, this strategy has been abandoned in February and will be excluded from the global strategy of the Fund for the near future.

In Europe, the ECB could implement new ultra-accommodative programs in order to fight against the collateral damage of the US Treasury sell-off on the European bond market.

Some high-quality Emerging Markets could offer investment opportunities, driven by demand and by the weakness of the US dollar.

As a result, we believe that the best strategy today is to invest in a selection of high-quality corporate bonds, both in EUR and USD, favouring hybrid debt and high-quality Emerging Markets.

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 Funds plc.

Registered in Ireland.

Contact

E.I. Sturdza Strategic Management Limited

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

Fund Strategy

In February, we continued to favour credit spreads, but more importantly, sold the remaining positions in 30y Treasuries (nominal and real yield TIPS) before the acceleration of the sell-off. In the credit market, we sold Cez and America Movil (due to tight spreads in Euro), and also reduced the Telefonica position. SP Power Assets was sold on the back of a weaker ESG Sustainalytics score (from high to severe risk). We increased the weight of NextEra (senior bond) and some hybrid corporates. In the Euro market, Iberdrola was added to the portfolio and we increased the weight of Repsol. In the Dollar market, we increased the weight of BP and Bimbo.