Strategic Bond Opportunities Fund

May 2021 Fund Commentary

Market Development

During May, long-term US Treasury yields remained fairly static despite several surprises in the macroeconomic environment. The month began poorly with disappointing job report data. With only 266,000 job creations compared to the one million expected, and the unemployment rate climbing from 6% to 6.1% (5.8% expected), the financial markets did not really react, believing that subdued economic data will encourage the Fed to maintain its dovish monetary policy.

Then came the CPI and its historical 4.2% gain. Even more concerning, the core CPI reached +3%, which should, under normal circumstances, prompt the Fed to adopt a more restrictive policy.

The US central bank continued to affirm that this inflation peak is only temporary, and experts repeated that the best indicator of inflation observed by the Fed is the Core PCE Deflator. Unfortunately for the most optimistic investors, the Core PCE deflator reached +3.1%, the biggest increase since 1992. Finally, the minutes of the last FOMC were published and revealed that many board members of the Fed want to begin talks regarding the decrease of asset purchases, i.e. the tapering. In this environment, credits were still attractive, as many investors believe that TINA (There Is No Alternative) is probably the best strategy. Subordinated debt spreads slightly widened this month, and Emerging Markets were affected by three concerns: the COVID pandemic; economic problems; and political instability (in South America notably).

Market Outlook

Our outlook remains focused on the macroeconomic situation (including growth and inflation), Central Banks' behaviour (the timing of tapering) and the evolution of equity markets. At the same time, the COVID pandemic is not over, and the delays in vaccination plans throughout some regions are affecting the recovery in Emerging Markets (Latin America and Asia ex-China in particular). Inflation fears in the US continue to be an issue, but the behaviour of the Fed towards tapering is likely to become the major source of concern. As a result, tapering, or more precisely talks regarding the timing of tapering (expected to beheld during the Jackson Hole meeting this summer), should become the major driver of the US Treasury market in the coming weeks. We, like the Fed, believe that consumer prices will increase (possibly sharply) during the coming months, but inflation should come down in Q3 and Q4. Global growth is expected to increase gradually in the coming months in Asia, Europe and more importantly and rapidly, in the US.

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 reasonable levels. We are not excluding a continuation of the sell-off, but should long-term yields reach higher levels, such as 2% for the 10y, this could become a buying opportunity.

In Europe, the ECB could implement, if needed, new ultra-accommodative programs in order to combat the collateral damage of higher US Treasury yields 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, but the political and health situation in Latin America are, for the time being, too risky and uncertain to consider investing in this region.

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.

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As a result, we are of the opinion that the best strategy today is to invest in a selection of high-quality corporate bonds, both in EUR and USD, favouring USD Investment Grade and hybrid debt (both in EUR and USD). The strategy implemented in May is likely to be expanded during the coming weeks. High quality credit spreads are a sweet spot in the current environment, but short maturity (3-5y) spreads are too tight. The strategy is to buy longer maturities (7-10y instead of 3-5y) while partially hedging their higher duration through a duration overlay policy, selling 10y Treasury Futures CBoT.

Fund Strategy

We continued to favour spreads throughout May, USD Investment grade in particular. We bought two new names in this asset class, Orange 2031 and Thermo Fisher 2030. We also increased the weight of New York Life 2028, Verizon 2027, Ebay 2030 and Deutsche Telekom 2030. In the Hybrid market, a new position in US dollar has been built with Stanley Black & Decker. Two positions were sold out: Korea East-West Power due to ESG concerns; and a remaining position in Cofide 2027 due to political instability in Peru. More importantly in terms of strategy, with the purchase of many long-dated credits, a duration overlay policy has been initiated with the sale of 80 10y Treasury Future contracts.

Ratings & Awards

Morningstar Sustainability Rating

Out of 522 Global Fixed Income-funds as of 30/04/2021. Based on 72.61% of AUM. Data is based on long positions only.

See Awards Disclaimer on last page.

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