E.I. Sturdza Strategic Bond Opportunities Fund

February 2019 Fund Commentary

MARKET DEVELOPMENT

In February, the markets focused on global growth, or more precisely on the global slowdown. Many uncertainties such as the Brexit and the US-China trade negotiations persisted. The month started with the publication of very strong unemployment figures: 304’000 jobs were created in January, giving room for a less dovish Fed and a bearish steepening of the US Treasury curve.

At the same time, in Europe, Italy officially went into recession, whilst the European Commission unveiled its latest economic forecast. Growth in the Eurozone for 2019 has been cut drastically from 1.9% to 1.3% (including a sharp revision of Italy’s growth from 1.2% to 0.2%). At the same time, inflation projections were revised from 1.8% down to 1.4%.

The publication of the minutes of the FOMC meeting in January revealed a more dovish tone of the Fed. The key word was “patience” but at the same time some US central bankers remain worried about inflation pressures. The big question mark was the Fed’s policy regarding the extent to which it would reduce its balance sheet (known as Quantitative Tightening, QT). The current policy, totalling USD 50 billion per month and 600 billion for the entire year, would have an equivalent impact of around three rate hikes, which in the Investment Adviser’s opinion is too much and would lead to a recession. As a result, the major topic became (and still is, as no answer has been given by Jay Powell) the behaviour of the FOMC regarding QT.

At the end of the month, two positive developments were announced: in Europe, Fitch confirmed the BBB rating of Italy (lowering concerns about a downgrade into the junk category) and in the US, Donald Trump refrained from imposing a new wave of tariffs (USD 200 billion of Chinese goods) that should have been implemented on 1st March, as discussions with the Chinese made significant progress.

PORTFOLIO STRATEGY

During the month, the strategy of the Fund has been slightly modified. Due to uncertainties regarding the behaviour of equity markets, the Investment Adviser decreased the weight of subordinated debt in Euro, mainly hybrid corporate bonds: the team sold Volkswagen and Telefònica hybrid bonds and decreased the weight of Santander Tier II 2025. In the Euro market, the team almost doubled the weight of Ferrari 2023, whilst selling Pernod-Ricard 2022 and buying KDB 2024 in the Dollar market. Further, the weight of Hutchison Whampoa 2022 and Enel 2025 were increased. As per usual, the whole exposure to EUR denominated bonds was fully hedged into USD.

With regards to the US Treasury market, the team raised the weight of 2y, 3y, 10y and 30y Treasuries in order to increase the barbell strategy, whilst at the same time building a small position in 4y Treasury. As a result, the modified duration has been maintained above 5.

MARKET OUTLOOK

The Investment Adviser’s outlook continues to be tied to two major topics, inflation and Central Banks’ stand-points. Inflation risk remains subdued and the US yield curve keeps flattening. In combination with other topics such as the risk of the trade war escalating, this suggests that recession fears (or at least fears of a significant slowdown) are a major concern.

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@eisturdza.com

eisturdza.com

In the US market, the Investment Adviser believes that long US Treasuries are still attractive, considering that they could be a top performing asset class in 2019. A more inverted curve slope can not be ruled out in 2019.

The Investment Adviser thinks that the best strategy currently is to keep investing in short term corporate bonds and investment grade Emerging Market bonds yielding around 3.5%, combined with 10y and 30y US Treasuries. The Fed's behaviour will be a key driver of the markets and bond yields will also depend on the evolution of equity markets. The Investment Adviser believes that a US rate hike will not be possible in 2019 and that the Fed will probably be forced to ease before year end or drastically amend its balance sheet reduction program (QT).

In Europe, the team believe that the Bund will match the US Treasuries' behaviour and, in addition, will perform well as recession fears are likely to increase over the coming months. Uncertainties around Brexit will add additional stress to the market. A QE2 will probably become inevitable in the Eurozone before the end of the year in the Investment Adviser's opinion.

In Emerging Markets, the team will continue to closely monitor the behaviour of spreads (both governments and corporates) in order to add some carry in the short term part of the portfolio. Spreads have widened substantially in 2018 and some Emerging Bonds could still perform in 2019, despite the strong rally already observed during the two first months of the year.

In conclusion, the Investment Adviser maintains the belief that the best performing asset class is a mix of short term Investment Grade corporates and long-dated US Treasuries. Very high-quality Emerging Markets still offer an attractive investment opportunity. Bonds denominated in Euro and hedged in US Dollar are also a very attractive investment opportunity. In the Investment Adviser's view, a mix of all these sub-asset classes will represent an opportunity to deliver robust performance in 2019 despite a very low yield environment.

AWARDS

CITYWIRE PLATINUM

CITYWIRE BRONZE

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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 15/03/2019 and are based on internal research and modelling.

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