E.I. Sturdza Strategic Bond Opportunities Fund

June 2019 Fund Commentary

MARKET DEVELOPMENT

In June, the bond markets continued to be supported by ongoing uncertainties around trade tensions and concerns about the strength of the global economy. In the US, some "cracks" started to appear despite a robust domestic economy and low inflation environment. The May Non-Farm payrolls added 75k jobs, falling short of the estimated 175k, with consumer confidence dropping to its lowest level since 2017*. The US Fed chief, Jerome Powell, left rates unchanged but mentioned that many FOMC participants were concerned about global growth and trade developments, which may lead to a potential rate cut in July.

In Europe, industrial data is weak and manufacturing sector activity continued to slow, particularly in Germany, leading the Bundesbank to cut its economic forecast. The ECB for now maintained its key interest rates unchanged, with Mr Draghi however reiterating that the ECB is ready to act and use "all the instruments that are in the toolbox". During the Sintra Forum on Central Banking he indicated that the bank could cut rates further and implement a new round of quantitative easing if inflation remained below the Bank's target. As a result, this month has been characterised by strong monthly performances in various asset classes: +0.92% (Bloomberg-Barclays US Treasury total return), +2.22% (Bloomberg-Barclays Global Aggregate) and +7.05% (S&P 500 TR) respectively. According to the team, the semester ended with the strongest and broadest cross-asset rally since the Great Financial Crisis as Central banks have been more dovish than markets expected.

PORTFOLIO STRATEGY

During the month, the Investment Adviser decreased the Credit exposure slightly by reducing or selling cyclical and trade war-sensitive issues. Further, the team increased the Barbell strategy by buying short and long-dated US Treasuries, maturing in 2020 & 2048.

MARKET OUTLOOK

The Investment Adviser's outlook remains tied to two major topics, inflation and Central Banks' behaviour. Inflation risk remains subdued in the US and substantially below the ECB target in the Eurozone. Flatter yield curves indicate a late credit cycle in the Eurozone and a more mature one in the US. Fears of a significant slowdown have increased as trade war risk is hurting global investment.

In the US, the Investment Adviser believes that long term US Treasuries are still attractive and may be a top performing asset class in 2019. This said, following the strong rally observed since the beginning of the year, the team may pause the current strategy by momentarily reducing its duration exposure. The team believe that a further inversion of the curve's slope is still not excluded in 2019, considering a first Fed rate cut is likely to occur in July based on global sub-trend growth. The Investment Adviser thinks that the best strategy today is to keep investing in a selection of short term high quality corporate bonds and investment grade Emerging Market bonds, combined with a barbell strategy on the US Treasury yield curve, with an overweight of 1-2y combined with 10-30y US Treasuries.

*Source: Bloomberg. July 2019.

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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According to the team, the Fed's behaviour will be a key driver of markets, with bond yields also depending on the evolution of equity market trends. The Investment Adviser believes that the Fed will probably be forced to ease significantly before year end or even implement a QE4 before Q2 2020.

In Europe, the team believe that current macro conditions and Brexit uncertainties require further accommodation from the ECB, with a QE2 likely becoming unavoidable in the Eurozone before the end of this year.

In Emerging Markets, the Investment Adviser will continue to closely monitor the spread patterns (both governments and corporates) and the EM countries' ability to absorb trade shocks.

In conclusion, the team still believes that the best performing asset class is a mix of high quality short term Investment Grade corporates combined with long term US Treasuries. According to the Investment Adviser, high-quality Emerging Markets still offer an attractive investment opportunity and Bonds denominated in euro and hedged in US dollar also offer an attractive carry. This said and given the current environment and global spread-widening risk, the team may continue to increase the weight of US Treasuries, reducing exposure to the three other pillars (corporate spreads in dollars, Emerging Markets in dollars and corporate spreads in euro). They believe that a mix of High Grade corporate carry and US Treasuries will present an opportunity to deliver a robust performance in the coming months despite a very low yield environment and an outstanding performance since inception of the Fund.

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 18/07/2019 and are based on internal research and modelling.

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