

*Please note that the commentary is for the US dollar retail class of the Fund. The feeder Fund is 100% invested in the underlying US dollar Fund. However, given small valuation, trading and translation differences for the two Funds, investors should expect differences in returns in the short term. Over the long term, we aim to achieve the same outcome in US dollar terms for both Funds.*

For global fixed income markets, the start of 2024 was dominated by a singular phenomenon: a recalibration of expectations for easing by major central banks, especially the US Federal Reserve (Fed). The combination of an excessive overextension of priced rate cuts hitting an atypical and contradictory run of macroeconomic data forced a major re-think of short-end interest rates across most major markets. The notion that there is no such thing as a steady plateau to any interest rate cycle has been aggressively reinforced over the course of 2024 to date. Against this backdrop, the Fund returned 1.4% for the quarter and 6.0% for the 12-month period, in line with the benchmark return.

#### Asset class performances

Almost as quickly as the closing months of 2023 witnessed very strong and coordinated compression in Developed Market (DM) sovereign bond yields, this was dramatically reversed over the course of Q1-24. While there was a divergence of central bank guidance and policy moves in the first three months of the year, the most significant driver was the Fed's signalling that rate cuts in the US were not nearly as imminent as markets had started to anticipate. What made this such an acute episode of interest rate volatility was the degree to which interest rate easing had been anticipated. For a brief moment during January, market pricing had built in an assertive easing cycle of seven consecutive interest rate cuts in the US, with the first cut looming.

However, a powerful – and unusual – combination of consecutive and coordinated data prints in the US brutally swung the narrative in the opposite direction. The persistence of a much more resilient labour market than was believed feasible, especially sticky inflation prints, and activity data that reinforced a view around existing pockets of strength and allayed fears for the weaker areas, became impossible to discount as mere statistical blips. And what deserves recognition here is that market-based expectations have been the most wildly flung about. The Federal Open Market Committee (FOMC) itself had in no way been as committed to the extent and forthcoming timing of the interest rate cycle that the market had worked itself up into a frenzy over. As such, the adjustment made by most Fed officials has been to acknowledge the steer provided by the most recent batch of macro-data but not go as far as to rule out the peak of the tightening cycle having been achieved.

The net result for the US Treasury curve was a meaningful bear flattening move over the quarter, with limited and short-lived pull-backs along the way. Short-end rates naturally rose the most as the number of cuts priced in over the next 12 months moved from over seven to only three. But long-end rates also adjusted higher, with the 10-year US Treasury (UST) reaching a low of 3.88%, a high of 4.32% and ending the quarter at 4.2%. This was partly as a consequence of adjusted monetary policy expectations but also much stickier inflation than expected and unsupportive fiscal dynamics.

By-and-large dynamics seen across other major DM bond curves over Q1-24 reflected the underpin provided by USTs. This was exactly the case in the eurozone, despite central bank pricing here echoing much less resilient macro developments over the quarter. Indeed, while inflation in Europe also proved stickier – buoyed up by services, much like elsewhere – activity also remained much more insipid relative to the US, even if signs of bottoming out have become more widespread. Similarly in the UK, where inflation is still high in absolute terms – especially when compared to its closest peers – the dynamics seen since the start of the year have been more favourable. Regardless, the FOMC, the European Central Bank and Bank of England echoed each other in signalling no rush to adjust rates off their peaks and all emphasising that more data is required to assure themselves that inflation is moving sustainably to target levels over the medium term before rate cuts can be implemented.

The outlier in the DM interest rate space during Q1-24 wasn't – as one would certainly have thought – Japan, but rather Switzerland. Here, the Swiss National Bank (SNB) became the first G10 central bank in this cycle to cut rates, seemingly having contented themselves that inflation was largely a battle-won. Here, a twist in the government bond yield curve was seen, with short-end rates declining over the quarter while long-end rates rose. In Japan, the opposite course was struck, with monetary conditions tightened by the Bank of Japan (BoJ): negative interest rates and yield curve control were removed during the quarter. Favourable labour market data – especially around pay hikes – was largely responsible for the BoJ feeling more comfortable with edging slightly further away from a still extremely accommodative monetary stance. The hope for a persistent break out of consumer price deflation in Japan hasn't been as elevated as it currently is for at least a decade.

When contrasting the movements of DM nominal yield curves over Q1-24 with their real yield counterparts, an important signal is extracted. An about-turn in short-term monetary policy expectations, combined with introspection about the potential depth of easing cycles across the G10, motivated a fairly uniform increase in real yields across the term structure. In the case of the US, for example, the 10yr Treasury Inflation-Protected Securities real yield was around its lows at the beginning of the year of 1.70%, before closing just under 2.0% by quarter-end.

But over in the Emerging Markets (EM) sphere, there's been more divergence in central bank actions and posturing. For one, a few key EM central banks had already embarked on their easing cycles prior to the start of the year and found it straightforward to persist with their established policy stances (Brazil, Chile and Colombia are key examples). A notable addition to the rate-cutting segment of the EM world was Mexico, which finally implemented its much anticipated first rate cut in March.

With respect to EM local currency bond performances, there was actually fairly limited dispersion in pure bond returns in local currencies, with the exception of Uruguay (up 5.08%), for idiosyncratic reasons. At the bottom of the ranking table in local terms, was South Africa (-1.9%), Hungary (-1.8%) and Peru (-1.5%). When taking into account currency movements, this shifted a little: Chile (-11.7%), Turkey (-8.6%) and Hungary (-6.8%). EM gainers during the quarter didn't distinguish themselves particularly; with core bond market rates lifting meaningfully, there were very few localised developments within each of these markets of enough magnitude to overcome the severity of the repricing of global core rates. For the year to date (YTD) up to end March, the overall EM debt market (local currency, unhedged in USD) had returned -2.1% (+5.24% over 12m).

In contrast to the return of local EM bonds negatively impacted by currency movements and the strength of the USD, in particular over the first three months of 2024, external EM debt notched up a respectable return, with the EMBI Global Diversified Index gaining 2.0% in the quarter and +11.3% for the 12 months to end March. However – and this deserves some emphasis – these gains were very heavily tilted towards outsized returns provided by a small number of previously maligned and exceptionally poor quality issuers, with very specific, localised developments. Indeed, the most important sub-class of exceptional performers was that of defaulted or particularly fiscally stressed sovereigns, such as Ghana (+17.2%), Zambia (+18.6%), Egypt (+22.2%) and Ukraine (+25.2%). Indeed, when looking at the high-quality EM sovereign issuers (all those rated "A", for example), a modestly negative -1.2% total return was seen for the quarter, largely as a result of core interest rate movements – but still a negative all-in performance on average.

In contrast, for many other global spread markets, the first quarter of 2024 was a continuation of the favourable run seen in excess return terms in the preceding quarters. But what makes this result particularly noteworthy is both the starting levels for spreads (already quite stretched) and the prevailing macro backdrop (a re-thinking of the underlying interest rate environment). Both in the US and Europe and across the credit quality spectrum, the asset-class specific return provided by a continuation of spreads compressing was persistent, even if a bit slower than seen on average over the course of 2023.

In the US, the Investment Grade (IG) market returned an unremarkable -0.1% in total return terms for Q1-24 (vs +8.4% for 2023). But, of course, this was all down to the steep reversal of underlying interest rates. In excess return terms, the overall blue-chip credit market in the US provided +1.0% in Q1-24 (vs +4.7% for 2023). The US High Yield (HY) market reflected a similar dynamic, although outright gains from continued spread compression actually still managed to outweigh losses imposed by higher base rates. Total returns for the overall market here were +1.5% in Q1-24 (vs +13.5% for 2023), led by excess returns of +1.7% in Q1-24 (vs +9.1% for 2023). At a broad market level, both IG and HY spreads ended the quarter essentially around levels last seen during the depths of the post-Covid recovery phase (2021).

Q1-24 was a positive one for risk assets, particularly equities, and was also a widely shared phenomenon across sectors and geographies. Indeed, the primary theme remained centred around AI and semiconductor entities, although corporate reporting and idiosyncratic developments in major markets provided a basis for the support of other sectors. The notable exception to the rising tide – even if at vastly different speeds – was the real estate sector. Indeed, with such a substantial re-assessment of the Fed's interest rate path over 2024 and beyond, it certainly wasn't unusual to see property sectors take the brunt of this change of view. The FTSE EPRA NAREIT Global Index (TR) returned -1.0% in Q1-24, in contrast to the MSCI World (net TR) Index of +8.9%.

#### Fund activity

With respect to Fund activity over the quarter, as is mostly the case, the bulk of transactions related to the recycling of existing exposures that had drifted into modestly expensive territory and were replaced by new issues perceived to be relatively cheaply priced. This tends to occur within the higher-rated credit buckets involving short-dated issues (usually one to three years). There is also the natural recycling of maturing issues, given that the Fund tends to have a meaningful and continuous liquidity ladder spanning from one quarter to the next.

In the lead-up to the end of 2023, the Fund had been actively de-risking away from credit product as these markets had become increasingly expensive from a long-term valuation perspective. In addition, with interest rate expectations and term premia also becoming stretched, it was increasingly easy to also reduce pure interest rate risk that had been accumulated in prior times. Thus, coming into the start of 2024, the Fund had moved deliberately and progressively to reduce aggregate interest rate and credit risk based on over-stretched valuations. This proved beneficial, as interest rates swung very sharply around over the course of the first three months. Credit markets continued to have a reasonable run – and thus there was a modest opportunity cost of having disinvested here – but on a risk-adjusted basis, this still remains definitively the most appropriate course of action to have taken.

As always, the Fund found attractive idiosyncratic risks to accumulate during the quarter, although these are becoming increasingly rare to find as expensive valuations broadly sweep up spread markets, with little relief to be found. As a broad indication, the Fund has still managed to find reasonable opportunities within select sovereign EMs; certain classes of bank debt and subordinated issues from within the European insurance sector. But the true opportunity set that opened up lay within the property sector, especially on the equity side. Here, the broad re-pricing of interest rates across the vast bulk of the G10 provided a solid headwind to REITs, which had incorporated imminent and substantial interest rate cutting cycles over 2024. While there certainly remains a meaningful risk in the eventuality that DM interest rate cycles aren't initiated during 2024, the pressure that broad swathes of the real estate sectors experienced globally certainly provided good entry points to accumulate further exposure to our favoured names.

#### Portfolio managers

**Nishan Maharaj and Seamus Vasey**  
as at 31 March 2024