

**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.**

The second quarter was nearly a full round-trip for monetary policy expectations in the US. The country's interest rate markets remain acutely sensitive to the latest data flow and how this is perceived to bolster the case for or against the Fed initiating an interest rate cutting cycle. This is likely to remain the case, at least for the very near term. For their part, the Federal Open Market Committee (FOMC) has been less immediately reactive to high-frequency macroeconomic data, instead maintaining a more consistent stance that emphasises a risk-management approach to policy setting. Regardless, for US interest rates, the first half of 2024 has been wholly dominated by the influence and role of monetary policy expectations. This certainly hasn't been resolved, but there's definitely scope for additional drivers to become relatively more prominent. In particular, the approaching Presidential elections alone have the ability to weigh more heavily on US rates markets as prospects and risks are expressed in varying risk premia.

Within global fixed income markets, the potential for differing trajectories and cadence of monetary policy paths to more definitively express themselves as time passes is undoubtedly growing. This is a feature to look forward to, as this type of environment tends to produce more varied opportunity sets and unaligned markets – just the kind of landscape the Fund is designed to navigate.

Against this backdrop, the Fund returned 1.16% for the quarter, marginally behind the benchmark return of 1.51%, bringing its 12-month return to 6.21% versus the benchmark's 6.07%. Since its inception, the Fund has outperformed its benchmark by 0.77% per annum.

#### Asset class performances

The extreme reversal of market expectations for US monetary policy seen in the first quarter of the year became turbo-charged during April. With high-frequency data flow suggesting that US consumer inflation was worryingly irrepressible, helped along by a robust labour market and encouraging indications that the pockets of weakness in the US economy weren't deteriorating further, there was a moment during Q2-24 when the market became collectively doubtful that the FOMC would have any capacity to reduce interest rates in the foreseeable future. This episode was accompanied by the heightened debate around the potentially altered level of the 'neutral' policy rate needed in the US. So, not only were rate-cutting expectations for this monetary policy cycle radically reined in, but also the potential for a deep cutting cycle became much more contestable. The notion that the US might require higher interest rates than seen in the past two decades – at all points through a monetary policy cycle – became much more entrenched during Q2-24.

The response of the US yield curve was to bear flatten: Interest rates of all maturities rose, but short-end rates modestly more so as both the immediacy and depth of the anticipated rate-cutting cycle were scaled back. As such, the yield curve remained inverted over the course of Q2-24. For example, the 10-year US treasury bond yield remained at 30 to 45 basis points (bps) lower than that of the two-year bond yield, albeit at higher absolute levels for both. The weakest point (highest yields) for US treasuries overall was reached during April, which was the apogee of cyclically strong high-frequency data releases. Across the board, inflation measures surprised to the upside; job gains were the strongest they'd been for around a year; retail sales had another strong month; even the leading manufacturing indicators suggested a revival after struggling year-to-date. The net result was that long-dated US interest rates reached their temporary peaks in late April, nearly 100bps off their lowest points seen in the closing days of 2023.

The remainder of the quarter saw a partial walking back of the almost complete nullification of a near-term cutting cycle in the US. However, this process has been erratic, with elevated sensitivity to incoming data flow, and US interest rates exhibiting heightened volatility. Though recovering c.30bps from their peaks in late April, US yields still ended this quarter marginally higher than at the end of March. Nonetheless, the net result was a modest positive performance on the quarter for US treasuries overall, driven by interest returns (i.e., coupon payments).

And this stands in contrast to many of the other Developed Market (DM) sovereign bond markets. In Europe, movements in bond yields over the quarter were less prone to seismic changes in monetary policy expectations. The case for easing rates had been clearer all along in the eurozone and the ECB had provided consistent guidance. Indeed, June saw the first 25bps policy rate cut from the ECB taking the refinancing rate from 4.5% to 4.25% – a move that had been long anticipated. Rather, the dominant feature for euro area government bonds in Q2-24 was the precipitous rise of political risk above and beyond the long-standing ructions of the region. Central to this was the outcome of the European parliamentary elections in early June where far-right parties had their best results ever to collectively win nearly a quarter of the seats. This was particularly meaningful for France, where President Macron's party fared especially poorly, leading to the extremely unexpected calling of a snap parliamentary election in France. Markets rightly perceive elevated risk here, as a swing away from the current centrist government would likely entail a greater fiscal burden when France's deficit already exceeds the EU's borrowing limit. But it isn't just France. The potential for the European political backdrop to pivot meaningfully in the near term has grown as a consequence of developments in recent months. Up until the end of June, the net response had been for higher risk sovereign

premia to be incorporated into most eurozone bond markets with the exception of a few smaller members, such as Croatia, Lithuania and Slovakia.

Among global inflation-linked bonds, the trend seen across the quarter was broadly uniform in most of the major DM inflation-linked markets. Real yields all ended up higher by the end of the quarter, led by short- to mid-maturity rates (3yr to 10yr), with less pronounced increases in long-dated real yields. Nonetheless, a fair degree of dispersion in total return outcomes over the quarter was seen, with the dollar bloc markets (New Zealand, Australia, the US and Canada) producing mostly strong positive performances, with much poorer outcomes across the rest of the G10, particularly in Japan and France, as real yields climbed meaningfully higher over the course of the quarter.

Within local currency Emerging Market (EM) bonds, a fairly wide dispersion of return outcomes was seen in Q2-24. The notable outlier to the upside was South Africa. Bonds here started Q2-24 on the back foot – the country index yield was above 12% – due to both external drivers as well as bearing an elevated risk premium in the face of impending national elections. An immediate relief response to the election outcome provided exceptional tailwinds to the local market. The other stand-out performer in this asset class was Turkey – again, for idiosyncratic reasons. Colombia and Mexico were the laggards here with both countries' bond markets producing negative returns over the quarter, even in local currency terms and despite high interest returns. What has become very evident in recent months is the increased importance of country-specific factors in driving varying performances within EM sovereign bond markets. This is an encouraging development, as the enhanced potential for security selection to prove fruitful naturally provides for a higher quality opportunity set and an improved ability to construct more robust portfolios.

Across hard currency EM bonds, broadly the opposite dynamic that was seen in Q1-24 played out over Q2-24. Whereas gains in Q1 were very heavily tilted towards outsized returns provided by a small number of previously maligned and exceptionally poor-quality issuers, these entities had some of these gains reversed in Q2. Zambia and Ghana were the interesting exceptions, as progress towards resolving their debt restructuring woes made headway. But overall, an allocation to short-dated, higher-quality sovereigns produced a modest but reasonable return, even as dispersion across this sub-component was quite elevated – in contrast to what was seen in Q1.

And finally – after multiple, successive quarters of excess returns – US corporate bonds slowed down in Q2-24. Investment grade bonds still managed to provide for positive excess returns in Q2. Still, these were the lowest seen since Q1-23. Total returns were outright negative, as losses on underlying Treasuries were impossible to circumvent. US high yield corporate bonds fared better. In the quarter, both excess and total returns remained positive. However, total returns were only fractionally positive and at their lowest levels since Q3-22.

Spreads in US corporate bonds have largely stabilised around their levels reached at the end of Q1-24. For the US Investment Grade (IG) Index, this was largely around the 90-95bps region. Note that the context for this spread level stands in stark contrast to that seen over 2022-23 (100-170bps). Indeed, prevailing spreads are essentially in line with those experienced at the very lowest levels achieved in the post-Covid recovery boom. The same is broadly true for lower-grade credits. The US High Yield Index spread experienced more volatility than its IG counterpart over the quarter, along with more significant weakness – but can broadly be construed as trading within a range aligned to the highly suppressed levels seen in 2021.

What was somewhat disappointing over Q2-24 was the aggregate performance of listed real estate. At a global level, this sector initially kept in line with the overall market during the first part of Q2 but gradually underperformed over the course of May and June. This was partially a result of differing sector performances, but the key point is that REITs didn't recover what had been eroded in Q1 when interest rate expectations had adjusted higher. Naturally, there was a fair degree of differentiation across markets. Still, the striking element across most geographies was that REITs haven't benefited much from a softening of monetary policy expectations in the last couple of months.

#### 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 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.

The Fund continued to find better opportunities to lighten up on spread product exposures over the course of the quarter than not. However, given that aggregate spreads were mostly stable – with patches of additional weakness for higher-yielding entities – the Fund's aggregate risk exposures were relatively similar at the end of Q2-24 when compared to Q1-24. Naturally, the composition of these exposures was modified as relative pricing adjustments encouraged recycling activity. In addition, as base rates sold off during the quarter, the Fund incrementally added interest rate risk to better position for the advent of monetary policy cutting cycles, especially in the US.

#### Portfolio managers

**Nishan Maharaj and Seamus Vasey**  
as at 30 June 2024