

*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 last moments of the third quarter of 2024 (Q3) saw a powerful convergence of factors, with the potential to extend many of the positive tailwinds seen in Q2. Global monetary easing has taken hold in a conclusive manner, but still largely motivated by increased confidence in a more benign inflation outlook, rather than a deleterious collapse of economic activity. There is also the potential that stimulus efforts in China – a key missing global growth engine – may be escalating to a more meaningful level in the months ahead. And through the combination of gradually slowing global growth and pressures easing in certain core commodity markets, near-term inflationary pressures, and the relaxation of an externally driven squeeze on consumer incomes may find further expression over the remainder of the year. If so, these ingredients for 'moderation', may well lend themselves to the extension of a favourable backdrop for global fixed income markets.

Against this backdrop, the Fund returned 2.26% for the quarter against the benchmark return of 1.53%. Since inception, the Fund has returned 2.51% compared to a benchmark return of 1.69%.

#### Asset class performances

If the second quarter was a period of elevated focus on the inflation trajectory in the US, then Q3 was defined by a concentrated emphasis on growth. A series of high frequency activity disappointments, but also successive reports suggesting accumulating labour market weakness, rejuvenated fears of a US recession. The data softness in the US wasn't universally broad-based, although manufacturing continued to lose momentum – a global phenomenon – and housing markets largely stagnated.

Together with an overall picture of continued disinflation, the Federal Reserve (the Fed) found it easier to shift emphasis from one of concern around whether consumer price inflation would continue to moderate to it guarding against the risks of a sharper growth downturn. This was communicated by the Fed over July and together with a concurrent string of weaker data paved the way for the much-anticipated inaugural US rate cut at the September FOMC meeting. While the first cut of the cycle was an assertive 50 basis points (bps) decrease, this was accompanied by the Fed Chairman making it clear that this wasn't necessarily the pace of future rate declines. Nonetheless, by the end of the quarter, markets were anticipating a terminal policy rate of somewhere between 2.75-3.00% by end 2025 – c. 100bps lower than at the start of Q3 and occurring substantially sooner than previously priced.

US rates fell substantially over the course of Q3. The yield curve bull steepened as short-dated interest rates fell significantly more than long-dated rates, initially in anticipation of the increasingly imminent start to the US cutting cycle but then spurred on by the larger-than-anticipated 50bps cut. After reaching a YTD peak of c. 4.7% in Q2, the 10-year US Treasury yield reached recent lows of c. 3.6% during September. Long maturity yields responded less intensively, and the yield curve steepened: 30-year US Treasury yields ended the quarter around 35bps higher than the 10-year point when the range earlier in 2024 had been largely 10-15bps.

Across the rest of the Developed Market (DM) bond markets, a similar picture materialised in Q3, although outright yield declines were the largest in the US. The market with the smallest yield declines in long-term rates was Japan. Here, a monetary policy cycle at odds with much of the rest of the world was primarily responsible. Otherwise, greater alignment in interest rate cycles across core DM central banks and mostly co-operative inflation trends allowed for considerable correlation across DM bond markets during Q3. Rate cutting hold outs, like Norway and Australia, saw their bond markets trailing the gains seen elsewhere. In the eurozone there was a fair degree of country differentiation, with the 'periphery' (Greece, Italy, Portugal, and Ireland) outperforming core Europe (Germany, France) by meaningful margins. The UK had one of the poorer relative bond outcomes in Q3, mostly as a consequence of pre-budget fiscal concerns re-emerging.

Global inflation-linked bond markets also had strong performances over Q3. Interestingly however, the best performing DM market here was Japan – a combination of firm inflation providing good contemporary accrual and a relatively modest pick-up in real yields. In contrast, US TIPS were the weakest of the DM inflation-linked markets even as good absolute returns were made. US real yields made their way to c. 1.5% by quarter-end (c. 2% for longer-dated) – lower than seen over the rest of 2024, but still elevated in the context of the post-GFC period.

Within Emerging Market (EM) bonds, the hard currency complex provided an aggregate three month return of c. 6%, of which c. 5% came from underlying base rate movements and the rest from spread compression. Returns improved further out along the yield curve, with the 10+ year sub-component achieving a total return of c. 8%. It was also the case that the weakest quality credits performed the best, with C-rated sovereigns having their credit spread compression contributing c. 300 bps to overall returns – a stark contrast to the highest quality EMs (A-rated), where credit compression barely added to overall returns.

For local currency EM bonds, a very strong outcome of c. +9.5% for the overall market was seen. Of note, currency performances out did those of the underlying bond markets themselves. Indeed, it was a particularly weak period for the US dollar overall, including against

other DM currencies. Renewed fears of US recession, an assertive start to the US rate cutting cycle and the yen carry-trade episode during July all worked against the US dollar, while geopolitical unrest, continued Chinese economic weakness and rumbling global trade tensions weren't enough to provide for an offset. Further assistance to EM local bonds came from monetary easing within these economies (with very few mainstream exceptions, like Brazil). However, unlike in DM economies, there really were fewer major surprises and shifts in market pricing of policy trajectories across EMs in Q3. The top performing markets in local currency terms were SA (+10.9%), Chile (+7.9%), and Peru (+6.8%). When including FX returns, the best markets were South Africa (+21%), Malaysia (+16.2%), and Indonesia (+13%). Uruguay (-4%) and Mexico (-1.6%) were the only negative markets overall, allowing for the strongest overall performance in local EM debt for at least the last 14 quarters.

For the most part, global spread markets ended the quarter broadly around their starting levels. However, there was a short-lived period of sharp weakness in the first couple of weeks of August, as several systemic level influences blossomed around the same time to promote a sharp retraction of risk appetite across global financial markets. It didn't take long before these fears subsided, prompting a full recovery in spread markets. In total return terms, corporate credit markets performed strongly during Q3, although this was almost entirely due to declines in base interest rates. For example, the US Investment Grade (IG) market returned c. 6%, while US High Yield (HY) returned c. 5.2% – modestly trailing on account of being a lower duration market. In spread terms, the US IG market closed the quarter at around 90bps, while the US HY spread was just above 300bps. These are very suppressed levels from an historical perspective.

Listed real estate markets, almost without fail, had a strong quarter. A combination of reasonable reporting periods and trading updates, together with more assertive easing cycles being priced across most markets, incited both earnings upgrades and a more favourable interest rate outlook for a particularly rate-sensitive sector. The FTSE/EPRA NAREIT Global Index returned an exceptional c. +16% for the quarter alone, taking the one-year total return to c. +30%. While some of this result is flattered by the tailwinds provided by a weaker US dollar, the firm fundamental underpin seen across the key component markets was unambiguous.

#### 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.

Over the course of the quarter, the Fund found plentiful opportunities to sell particularly expensive credits that had performed strongly, and which were not deemed to have sufficiently attractive remaining return for the underlying credit and/or market risk of the exposure. However, the generalised episode of risk aversion that occurred (very briefly) around the start of August did provide a good period to cautiously replenish aggregate credit exposure through particular securities that were seen as better value than had been available for several months. Note that the patch of weakness was neither particularly extensive nor long-lasting and impacted sectors and issuers rather unevenly. As such, the re-accumulation of credit risk within the Fund during this period was cautiously executed. While the episode provided pricing opportunities not seen for several months, the more important consideration was that even these 'cheaper' access levels were still fundamentally stretched on an absolute basis, hence the degree of caution exercised.

A more straightforward adjustment undergone by the Fund over the quarter lay with its interest rate risk. As monetary policy expectations in the US – but also in other markets – deepened progressively and extensive easing cycles were re-priced into the short end of yield curves, removing some of this exposure was the appropriate course of action. While the potential for exactly the depth and pace of easing by the Fed, ECB and BoE is undoubtedly feasible, this does imply a degree of economic stress that isn't strongly represented in current data and remains more of an adverse scenario. As such, allowing the Fund to be overly reliant on a 'hard landing' outcome isn't an attractive proposition at current pricing, hence the slow and steady curtailment of interest rate risk within the Fund over the quarter.

#### Portfolio managers

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