LIONTRUST

GLOBAL FIXED INCOME PROCESS

For professional UK investors only

Liontrust GF High Yield Bond Fund

Q1 2022 review

Fund managers: Phil Milburn and Donald Phillips.

The Fund (C5 sterling accumulation class) returned -4.2%* in sterling terms in Q1 2022 while the ICE Bank of America Merrill Lynch Global High Yield Index (GBP hedged) comparator benchmark returned -5.5% and the average return for the IA Sterling High Yield reference sector was -3.8%. The primary B5 US dollar share class returned -4.1%, while the ICE Bank of America Merrill Lynch Global High Yield Index (USD hedged) comparator benchmark returned -5.5% and the average return for the EAA Fund USD High Yield Bond (Morningstar) reference sector was -4.3%.

We also compare the Fund's performance to a leading Global High Yield ETF (seeking to outperform by 1.5% a year)[†]. The Fund's C5 sterling shares class return was in-line with that of the ETF in Q1 and has outperformed it by around 470 basis points since inception (June 2018).

The Market

Emerging from a period of such extreme market support was always going to be turbulent for capital markets. The pace at which monetary policy tightens is also being dictated by the rise and stubbornness of inflation, with it now pretty clear central bankers were behind the curve with the transitory rhetoric of 2021. Add to all this, war in Europe, with geopolitics turning the last three decades on its head. Risk premia clearly had to re-price to this new world.

With this backdrop, despite negative returns, high yield has been fairly resilient. The worst of the drawdown during the quarter was half that of the S&P 500 and much less than more growth-oriented measures like the NASDAQ. Meanwhile, if you had chosen to invest in gilts, you would have lost 7.5% in the quarter.

The outperformance of low-quality bonds has continued in Q1 2022. On one hand, this doesn't make a huge amount of sense given the spectre of stagflation; on the other, CCC rated bonds are skewed towards metals and energy, which will benefit from the enormous commodity price inflation we're seeing as a result of Putin's invasion of Ukraine. To be clear, the outperformance of low quality has been marginal in this quarter. We continue to dislike the asymmetric risks, maintaining our structural preference for high quality.

The Fund

Around one-third of the outperformance versus index is from the real estate sector, where we have not owned distressed Chinese real estate bonds. We have kept close to developments in the sector, but we have generally found it too opaque to invest.

Another sector which proved useful to avoid was leisure. With a concentration in airlines and cruising lines, rising energy costs is becoming a thematic risk. With this in mind, we switched part of our holding in Ardagh Packaging into the metal can subsidiary from the part of the group more exposed to glass packaging. Glass packaging is more energy intensive, although we believe Ardagh Group has more than enough resilience and pricing power in order to adapt.

During a period of broad market sell-off, there were few individual bonds that added material outperformance on their own. However, stock-picking collectively added around one-third to the outperformance versus index. Obviously, there are exceptions as not every decision can always go our way: the Fund's holding in Bausch Health bonds detracted from stock-picking, for example, costing the Fund around 10bps. Sentiment towards Bausch has been poor since it announced a more aggressive financial policy. We have reduced the Fund's holding size, but believe the company has enough strength in its core business and strategic flexibility to survive intact in the medium to long term.

During the quarter, portfolio activity has been relatively modest, although we have taken opportunities to switch bonds which have sold off less into bonds which have sold off more. An example of this was reducing our holding in CCC-rated Howden at the same price it traded in December and buying subordinated bonds issued by BBB-rated Telefonica ten points below the December level.

Since the start of the 2021, we've managed the Fund with some hedges in place designed to protect returns in a rising interest rate environment. In Q1 2022, these hedges gained the Fund ~30bps.

Outlook

There is plenty in the world to worry about, but we don't believe there is a material risk of a systemic rise in default rates. Of course, in a world of both higher interest rates and energy prices, profits and cash flow will be squeezed, but we believe there is enough quality and resilience in the high yield market to continue to make good risk-adjusted returns in this type of environment. This applies to BB-rated and B-rated bonds although, spoiler alert, we don't think this is the case in CCC-rated bonds!

US high yield spreads are still below the long-term average, but with the number of interest rate hikes priced into US government bonds, the overall yield is in line with the long-term average. Given the likely resilience the US economy has to continued conflict in Europe, we think US high yield is decent value.

However, with European spreads above the long-term average, we also like valuations in Europe. The Fund is split fairly evenly between US and Europe (including the UK), which in an index context represents a large European overweight. The Fund has light exposure to cyclicals and companies with high energy costs of production. We have zero airlines, which are so exposed to fuel costs. The quality bias we have within our process means we are light in CCC-rated risk, which is only 5% of Fund. Moreover, our quality bias means we seek companies with pricing power and resilience, two operational qualities that are the best defence in more difficult economic periods.

Discrete 12 month performance to last quarter end (%):**
Past Performance does not predict future returns

	Mar-22	Mar-21	Mar-20
Liontrust GF High Yield Bond C Acc GBP	-1.7%	24.0%	-9.1%
ICE BofA Global High Yield Hedge GBP	-3.5%	23.3%	-9.3%

*Source: Financial Express, as at 31.03.22, total return (net of fees and interest reinvested).
**Source: Financial Express, C5 share class, total return, net of fees and interest reinvested. As at 31.03.22. The primary share class for this Fund is in US dollars (B5) but we are showing the C sterling-hedged class to compare against the IA Sterling High Yield sector. Discrete data is not available for yen full 12-month periods due to the launch date of the portfolio.

†While the managers of the Fund seek to outperform a leading Global High Yield ETF by 1.5% a year net of fees over rolling three years, this is not a formal objective. There can be no guarantees this will be achieved over the stated time period. The formal objective of the Fund can be found in the Prospectus.

Key Features of the Liontrust GF High Yield Bond Fund

Investment objective & policy[1]	The investment objective of the Fund is to maximise total returns over the long term through a combination of income and capital growth, through investment in the global fixed income market. The Fund invests at least 50% of its assets in high yield bonds (i.e. bonds classified as below investment grade) issued by companies worldwide which are denominated in US Dollar or non-US Dollar bonds that are hedged back into US Dollar. Although the focus is on high yield corporate bonds, the Fund may also invest in investment grade corporate bonds, government bonds, cash or assets that can be turned into cash quickly. The Fund invests in developed and emerging markets, with a maximum of 20% of its net assets invested in emerging markets. Where the Fund invests in non-US Dollar assets, the currency exposure of these investments will generally be hedged back to US Dollar. Up to 5% of the Fund's currency exposure may not be hedged (i.e. the Fund may be exposed to the risks of investing in another currency for up to 5% of its assets).The Fund may invest both directly, and through the use of derivatives. The use of derivatives may generate market leverage (i.e. where the Fund takes market exposure in excess of the value of its assets). The Fund has both Hedged and Unhedged share classes available. The Hedged share classes use forward foreign exchange contracts to protect returns in the base currency of the Fund. The fund manager considers environmental, social and governance ("ESG") characteristics of issuers when selecting investments for the Fund.
Recommended investment horizon	5 years or more
Risk profile (SRRI)[2]	4
Active/passive investment style	Active
Benchmark	The Fund is considered to be actively managed in reference to the ICE BofAML Global High Yield Hedge USD Index (the “Benchmark”) by virtue of the fact that it uses the Benchmark for performance comparison purposes. The Benchmark is not used to define the portfolio composition of the Fund and the Fund may be wholly invested in securities which are not constituents of the Benchmark.
Sustainability profile	The Fund is a financial product subject to Article 8 of the Sustainable Finance Disclosure Regulation (SFDR).

Notes: 1. As specified in the KIID of the fund; 2. SRRI = Synthetic Risk and Reward Indicator. Please refer to the KIID for further detail on how this is calculated.

For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/glossary

Key Risks:

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

Investment in the GF High Yield Bond Fund involves foreign currencies and may be subject to fluctuations in value due to movements in exchange rates. The value of fixed income securities will fall if the issuer is unable to repay its debt or has its credit rating reduced. Generally, the higher the perceived credit risk of the issuer, the higher the rate of interest. Bond markets may be subject to reduced liquidity. The Fund may invest in emerging markets/soft currencies and in financial derivative instruments, both of which may have the effect of increasing volatility. The Fund may invest in derivatives. The use of derivatives may create leverage or gearing. A relatively small movement in the value of a derivative's underlying investment may have a larger impact, positive or negative, on the value of a fund than if the underlying investment was held instead.

Disclaimer

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