



Global Fixed Income

January 2024 review

Liontrust GF Strategic Bond Fund



Phil Milburn

Co-Head Global Fixed Income Team



Donald Phillips

Co-Head Global Fixed Income Team

The Liontrust GF Strategic Bond Fund returned 0.4%* in US dollar terms in January. The average return from the EAA Fund Global Flexible Bond (Morningstar) sector, the Fund's reference sector, was 0.1%.

Market backdrop

Government bond yields drifted upwards for the majority of January, driven by data showing stronger economic activity levels than expected as well as sticky services inflation. Towards the end of the month, a large profit warning from New York Community Bancorp (NYCB) catalysed a flight-to-quality rally in sovereign bonds as memories of the regional banking crisis of 2023 remain fresh in investors' minds. We deem the problems at NYCB to be idiosyncratic in nature, having to catch up with where most other banks were marking their commercial real estate exposure as well as adapting to more stringent regulations that accompany its larger balance sheet size. This left US Treasury yields close to unchanged during January, with bund and gilt yields slightly higher during the month.

Bond markets continue to try to price in the beginning of a rate cutting cycle across developed economies. Central bankers have been evolving their narrative to state that base rates are at a peak, but are not willing to commit to when rate cuts will begin. The stronger economic data and sticky services inflation will likely mean that rates are kept at these peak levels for a few more months yet. We continue to believe that rate cuts this year will be later than the markets anticipate, but larger in size once they do start. We expand below on the latest updates from the Federal Reserve, European Central Bank, and Bank of England.

The Federal Reserve's FOMC (Federal Open Market Committee) held fed funds rates in the 5.25% to 5.50% range. As had been widely anticipated, the tightening bias was removed from its statement. Previously the statement had used "...the extent of any additional policy firming," this has changed to "...any adjustments to the target range for the federal funds rate." The rationale for this is clear, as the FOMC sees that "...the risks to achieving its employment and

inflation goals are moving into better balance." However, it still views inflation as being "elevated" and so *"...The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent."* This all chimes with our central case of later but larger rate cuts in 2024. Finally, the FOMC plans to start an *"...in-depth discussion on balance sheet issues"* at its March meeting. In our opinion a tapering in the pace of quantitative tightening (QT) is likely to start during the summer.

The European Central Bank (ECB) also left rates on hold, in line with expectations. The deposit rate remains at 4.0%. Except for an energy-related blip in headline inflation, the ECB is seeing a declining trend in underlying inflation. Data dependency remains, with a focus on incoming data, the dynamics of underlying inflation, and the strength of monetary transmission. At the ECB press conference, President Lagarde stated that the consensus of the ECB's Governing Council is that it is premature to discuss rate cuts. She reiterated the mantra that the ECB continues to be data dependent, not date dependent. The ECB wants to see some of the catch up in wages being absorbed by profit margins, thereby curtailing second order inflationary impacts. On the exact timing of the rate cut, it was noted that 40% of those surveyed by the ECB wage tracker will produce fresh data over the next couple of months. Furthermore, fresh economic projections in March will be important to assess whether the economy, including inflation, is on the ECB's desired path.

Finally, the Bank of England's Monetary Policy Committee (MPC) also kept base rates steady, but there was a change to 2-6-1 in the voting split. Haskel and Mann were the two hawkish dissenters, judging that *"...there was evidence of more persistent inflationary pressures than included within the forecast."* The dovish dissenter was Dhingra who argued that *"...waiting for lagging indicators of domestic relative price growth to fall sharply before reducing rates would come with a risk of overtightening."*

In our opinion, the most interesting development was in the quarterly Monetary Policy Report (MPR) that accompanied the MPC statement. There is a big gap between the consumer price inflation (CPI) projections using market rates and those that are based off holding interest rates steady at 5.25%. Using market rates, CPI remains above target until 2027, using constant base rates creates a CPI undershoot. This implies that the Bank of England should be cutting rates, but by less than is currently priced into the markets. In reality, the accuracy of the economic modelling, including the CPI fan charts, has been called into question over the last few years. Either way, one area the MPC remains focused on is services inflation, the economic conditions for weakening services inflation are very gradually falling into place. The Bank of England will want to see further progress before it begins its rate cutting cycle.

Fund positioning and activity

Rates

The Fund remains at 7.0 years of duration exposure – a strategic long duration position. If government bond yields significantly rise, we would take duration back to 8.0 years where it was for most of the final quarter of 2023.

The geographic split of duration is US 3.1 years, Canada -0.5 years, UK 1.2 years, Europe 2.4 years, and New Zealand 0.8 years. We continue to prefer short-dated and medium-dated bonds, the net duration exposure in the 15+ year maturity bucket is zero.

Allocation

Investment grade exposure was reduced by 10% during January to 41%, 44% in physical bonds minus a 3% overlay. This was due to expensive valuations, explicitly credit spreads as opposed to total yield. We do not want to be hugely underweight compared to our neutral position of

50% as the fundamental outlook for credit is still benign and the asset class has decent yield carry; but this underweight gives a lot of risk budget to buy once credit spreads widen. We are targeting adding to credit during a period of volatility as opposed to anticipating a lurch higher in defaults and the permanent destruction of capital. The one area where we are concerned about capital loss remains CCC-rated credit. The Fund has zero exposure to this rating category. Within the rest of high yield, the Fund has a small underweight with 18% exposure, compared to a neutral of 20%. The 18% weighting is made up of 24% physical holdings and a 6% risk-reducing overlay.

Selection

The strongest performing bonds during January were in the real estate sector and we continue to believe there is fantastic value to be found within the sector. Given the volatility of real estate companies' bonds, we are carefully managing the position sizes, so we trimmed some Heimstaden Bostad after the large rally. On the purchasing side of the ledger, the Fund re-entered a position in Grifols' debt. The company was the subject of a short seller report, causing the equity to halve at one stage, while the bonds fell ten points. We examined the issues raised by the short seller, as well as the robust rebuttal from Grifols' management, and decided this represented a great buying opportunity.

The reduction in the investment grade weighting described in the Allocation section led to some outright sales of various issuers' bonds including Medtronic, Morgan Stanley, Oracle, AbbVie, and Amgen. All of these companies are very high quality and we have no credit concerns, the rationale was purely based on expensive valuations.

Discrete years' performance (%) to previous quarter-end*:

	Dec-23	Dec-22	Dec-21	Dec-20	Dec-19
Liontrust GF Strategic Bond B5 Acc	9.4%	-11.0%	-0.3%	7.7%	10.2%
EAA Fund Global Flexible Bond - USD Hedged	8.0%	-8.6%	0.1%	5.6%	9.5%

*Source Financial Express, as at 31.12.23, total return, B5 share class. Discrete data is not available for ten full 12-month periods due to the launch date of the portfolio (13.04.18).

For a comprehensive list of common financial words and terms, see our glossary at: <https://www.liontrust.co.uk/benefits-of-investing/guide-financial-words-terms>

Key Risks

Past performance does not predict future returns. You may get back less than you originally invested. We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

The fund manager considers environmental, social and governance ("ESG") characteristics of issuers when selecting investments for the Fund.

Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result;

The creditworthiness of a bond issuer may also affect that bond's value. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may have difficulty in paying their debts. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to pay.

Overseas investments may carry a higher currency risk. They are valued by reference to their local currency which may move up or down when compared to the currency of the Fund.

The Fund can invest in derivatives. Derivatives are used to protect against currency, credit or interest rate moves or for investment purposes. There is a risk that losses could be made on derivative positions or that the counterparties could fail to complete on transactions.

The Fund uses derivative instruments that may result in higher cash levels. Cash may be deposited with several credit counterparties (e.g. international banks) or in short dated bonds. A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

The Fund invests in emerging markets which carries a higher risk than investment in more developed countries. This may result in higher volatility and larger drops in the value of the fund over the short term.

The Fund may encounter liquidity constraints from time to time. Participation rates on advertised volumes could fall reflecting the less liquid nature of the current market conditions.

Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

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.

Disclaimer

This document is issued by Liontrust Fund Partners LLP (2 Savoy Court, London WC2R 0EZ), authorised and regulated in the UK by the Financial Conduct Authority (FRN 518165) to undertake regulated investment business.

It should not be construed as advice for investment in any product or security mentioned, an offer to buy or sell units/shares of Funds mentioned, or a solicitation to purchase securities in any company or investment product. Examples of stocks are provided for general information only to demonstrate our investment philosophy. The investment being promoted is for units in a fund, not directly in the underlying assets.

This information and analysis is believed to be accurate at the time of publication, but is subject to change without notice. Whilst care has been taken in compiling the content, no representation or warranty is given, whether express or implied, by Liontrust as to its accuracy or completeness, including for external sources (which may have been used) which have not been verified.

This is a marketing communication. Before making an investment, you should read the relevant Prospectus and the Key Investor Information Document (KIID) and/or PRIIP/KID, which provide full product details including investment charges and risks. These documents can be obtained, free of charge, from www.liontrust.co.uk or direct from Liontrust. If you are not a professional investor please consult a regulated financial adviser regarding the suitability of such an investment for you and your personal circumstances. All use of company logos, images or trademarks in this document are for reference purposes only.