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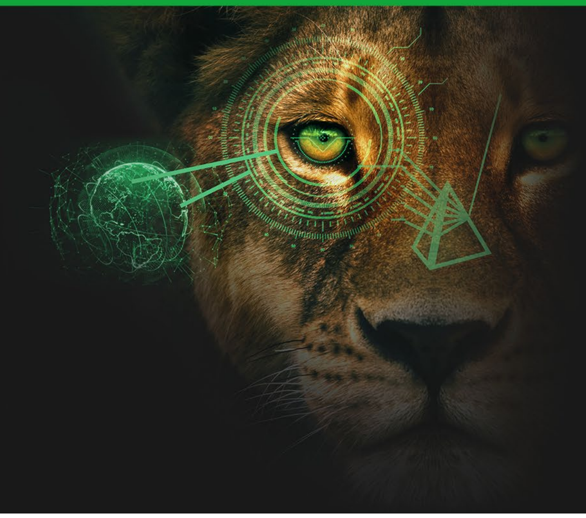

Global Fixed Income

June 2024 review

Liontrust Strategic Bond Fund

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The Liontrust Strategic Bond Fund returned 1.8%* in sterling terms during June. The average return from the IA Sterling Strategic Bond sector, the Fund's comparator benchmark, was 1.1%.

Market backdrop

June had a little bit of something for both bond bulls and bears. US employment data at the start of the month was very strong, the Federal Reserve moved their dot plot to only one rate cut in 2024, and US consumer price inflation was below expectations. Meanwhile in Europe, President Macron called a surprising snap election in France and the European Central Bank delivered on the widely expected interest rate cut but with a hawkish accompanying statement. The Bank of England took a dovish approach to holding rates steady, describing June's monetary policy decision as "finely balanced."

Regarding the US labour market job openings continue to fall, the latest vacancies/unemployed ratio is at 1.21x, well down from its peak of just over 2x. Hiring in May (released in June) was strong though, with nonfarm payrolls at 272k compared to expectations of 180k. Additionally, wage inflation ticked up; the monthly average hourly earnings were above expectations at 0.4%, which takes the annual number to 4.1% compared to expectations of 3.9%. The Fed wants to see wage inflation in the 3.0% - 3.5% ballpark for it to be consistent with its inflation target. The JOLTS quits rate was unchanged at 2.2%, a level consistent with falling inflationary pressures on wages. Leading indicators for the labour market point to further softening, but this is going to have to feed through more consistently into the payrolls data to persuade the Fed to start cutting.

As mentioned above, the Federal Open Markets Committee (FOMC) moved to a median dot of only one rate cut this year. Most market participants had expected the FOMC to move from three cuts at the prior Summary of Economic Projections (SEP) in March to two. The median for 2024 might be for one cut but the mode is still for two cuts; it would only take two FOMC participants to switch to shift the median. With the Fed down to only one cut forecast for this year it sets up the bond market nicely for positive surprises, e.g., lower inflationary data that could nudge the Fed into two cuts.

US consumer price inflation (CPI) was weaker than expected. Importantly, core CPI in May undershot at 0.2% compared to expectations of 0.3% consistent with April's rate. As always, the details matter – some of the undershoot was due to airfares which are volatile, but the broad picture was the most encouraging it has been so far this year. It is services inflation that has been the sticky last leg of inflation and the key concern for the Fed. Core services inflation was 0.2% during May, taking the annual rate to 5.3% and contributing 3.1% of the overall CPI basket. Within the monthly services inflation figure for May, shelter was the dominant driver; rents were up 0.39% and owners' equivalent rents (OER) up 0.43%. Shelter inflation is 5.4% over the last 12 months. OERs naturally lag current realised rents due to the BLS methodology; their inflationary rate should start to fall further in the second half of 2024 due to both lags and the washing through of the mix effect between single and multi-family dwellings.

The good news was found in core services excluding shelter, referred to as "supercore." The change in May was -0.04%, taking the annual supercore inflation rate back down to 4.83%. Supercore was flattered by a 3.6% fall in airfares, but prices elsewhere were well behaved. One other exceptional was motor vehicle insurance, which was down 0.1% in May compared to a run rate of +1.8% on average for the first four months of 2024. I'd expect some payback here next month as there are still higher insurance premia to be passed through in various states, but with the annual rate still at 20.3% (it was 22.4% last month) the worst of this will be behind us by the autumn. For most parts of supercore services inflation it is nominal wage inflation that is the biggest driver, and this is where the interplay between employment and inflation data is at its strongest. The Fed will be encouraged by this latest inflation data but want to see more of the same to attain greater confidence that this sticky last leg of the inflation problem is being ameliorated by restrictive monetary policy.

The European Central Bank (ECB) cut rates by 25 basis points to 3.75% as was expected by everyone and fully priced into markets. The rationale for the cut was as follows: "…*based on an updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission, it is now appropriate to moderate the degree of monetary policy restriction after nine months of holding rates steady.*" Thereafter, the statement and forecasts were mildly hawkish, which is consistent with the recent wage and inflation data. Most notably the statement deleted the sentence on conditions being "…*appropriate to reduce the current level of monetary policy restriction.*" The emphasis is on data dependence; this keeps September's ECB meeting in play but makes a July cut incredibly unlikely. Overall, I would view this ECB rate cut as moderating the level of restriction as opposed to the start of a rapid cutting cycle. I continue to believe that once the economic conditions are in place for more cuts, then they will be larger than the market is pricing for; but one needs patience as services inflation has not yet fallen enough.

Finally, the Bank of England's Monetary Policy Committee (MPC) held interest rates steady at 5.25% as was unanimously anticipated, the vote split remained at 7-2. The MPC minutes suggested enough members were more sanguine about recent high services inflation data than one would have expected, describing it as "…*somewhat higher than projected in the May Report.*" For a few, probably three, MPC members the data did not alter "…*the disinflationary trajectory that the economy was on,*" thus the decision to hold rates steady rather than cut was described as "…*finely balanced.*" I would interpret this as the MPC being really keen on cutting rates in August, but it just needs that pesky real-life data to not deviate quite so much from their projected view of the inflationary outlook. Key to this will be June's consumer price inflation data due out on 17th July and May's wage data due out the day afterwards.

As a reminder for all of these central banks, the exact timing of cuts does not matter to us as bond managers that much; what does matter is that the economic conditions are in place for the cuts. We remain strategically long duration and our confidence in the position has increased a little further this month.

Fund positioning and activity

Rates

Early in June we fortuitously took profits on the tactical addition to duration made at the end of May before the employment data. We remain strategically long duration; one is getting well rewarded with attractive yields while waiting. The direction of travel is for rate cuts even if the exact timing is hard to pin down.

We have preferred French duration to German duration and have made good money out of the position. Promptly after the market opened on Monday after Macron called the election we cut it by switching exposure into Bund duration. On the day, the first cut was the cheapest, 4 basis points wider, and a good example of being nimble when the facts change. Our other duration adjustment this month was to switch some US exposure into the UK based on valuations relative to economic prospects; the Fund's duration exposure to the UK is the highest it has been in over six years since launch.

Duration exposure of 7.5 years is now split between 2.9 years in the US, -0.6 years in Canada, 1.0 years in New Zealand, 2.2 years in the Eurozone, and 2.0 years in the UK. We continue to prefer short-dated and medium-dated bonds; the net duration exposure in the 15+ year maturity bucket is zero.

Allocation and Selection

There was some credit spread widening in the aftermath of the calling of the French election. Credit Default Swap (CDS) indices reacted more than the credit spreads on physical bonds; we therefore reduced the size of the CDS index overlay hedging high yield risk in the Fund. The position is still underweight at 14% compared to neutral of 20%; there is 18% exposure to bonds minus 4% remaining in the CDS overlay. Investment grade exposure remains below neutral too at 42% compared to 50%; this is 47% in bonds minus a 5% overlay. This underweight position in credit gives the Fund a lot of risk budget to buy once credit spreads widen. We are targeting adding exposure to corporate bonds during a period of volatility as opposed to anticipating a significant uplift in defaults and the permanent destruction of capital.

There were two new additions to the Fund during June, firstly it participated in a new lower tier 2 bond issue from Rothesay in US Dollars, which at a 7% yield offered great value. Secondly, a small position was established in Brightline East, a rail operator in Florida. The long-haul network has been built and the company is now growing the customer base. This will not be in a straight line but the convenience that rail offers is attractive for commuters and tourists. This is at the riskier end of investments for the Fund, but we are given comfort by the asset base the company has and big liquidity buffers built into the business plan.

The subordinated bonds in Heimstaden Bostad were sold as we have concerns that ratings agencies will lose patience and downgrade the company's senior credit rating. We also sold Grifols, at a very small loss, as the near-term positive catalysts for the investment case have now occurred. This leaves the company focusing on the longer-term deleveraging plan with attendant risks to this; if the bonds sold off, we would look to re-enter into a position.

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

	Jun-24	Jun-23	Jun-22	Jun-21	Jun-20
Liontrust Strategic Bond B Acc	9.6%	1.2%	-12.5%	5.1%	2.8%
IA Sterling Strategic Bond	8.8%	-0.2%	-10.2%	6.1%	3.8%
Quartile	2	2	3	3	3

**Source: Financial Express, as at 30.06.24, accumulation B share class, total return (net of fees and income reinvested).* Source: Financial Express, as at 30.06.24, accumulation B share class, total return (net of fees and income reinvested).

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

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