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Ninety One

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Investing for a world of change

Global yields still ripe for the picking

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The fast view

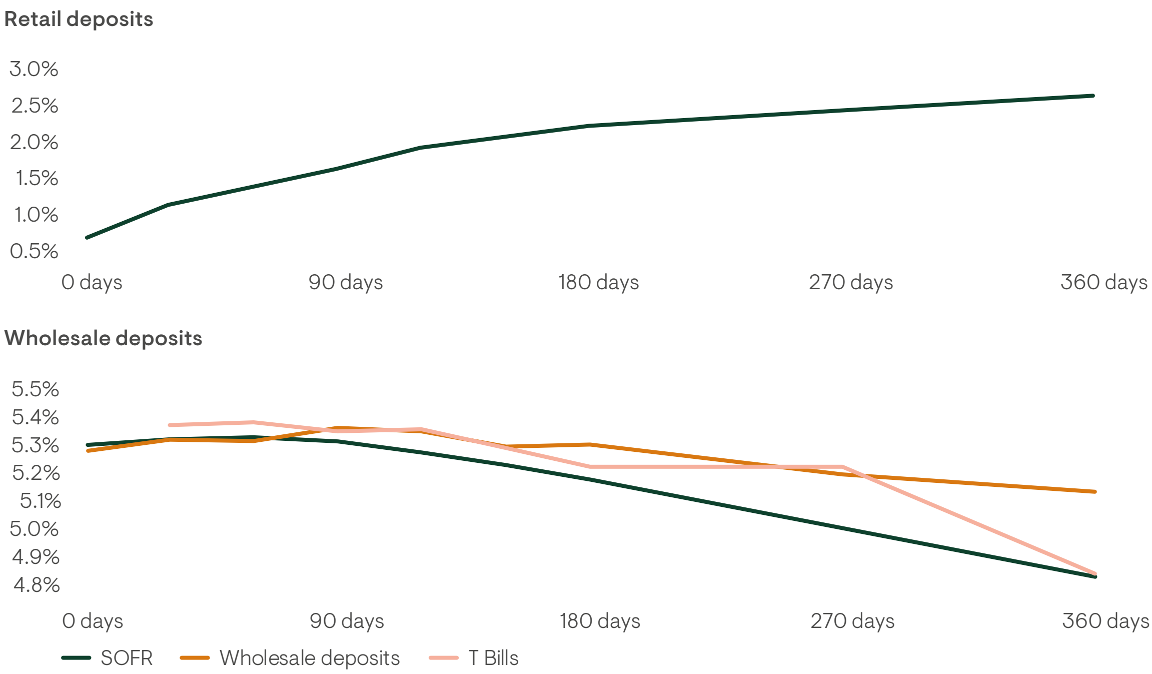
- Investors with money in dollar bank accounts have not benefited much from the material rise in global interest rates.
- While USD money market funds will give investors higher yields, the current environment provides attractive alternatives to further enhance returns.
- Conservative yield-seeking investors who have an investment horizon of at least 12 months, should consider investing in a global diversified income portfolio, such as the Ninety One Global Diversified Income Fund.
- This global fixed income portfolio targets a return of 1.5% above US dollar cash (gross of fees) over a rolling 12-month period, and no negative returns, also over rolling 12 months.
- By investing across global government debt, credit, and currency markets, we are able to maximise income and diversify the portfolio to mitigate risk.

Negative or near-zero global interest rates that followed the period after the Global Financial Crisis penalised investors as they were not being compensated for leaving money in their bank accounts. In some cases, depositors had to pay their bank for the convenience of holding their money. Low levels of interest rates forced investors into riskier assets to get higher income on their investments. Today, the picture is very different – we have seen a return to the 'old normal' in developed market interest rates as central banks have had to fight high inflation by raising interest rates aggressively.

The US kicked off its rate-hiking cycle more than 2 years ago, with many other central banks following suit. US interest rates are at more than 20-year highs, giving conservative investors an opportunity to benefit from a generous yield environment. Resilient economic growth and sticky inflation in the US indicate that interest rates are expected to stay 'higher for longer'.

The reality, however, is that retail investors do not benefit much from higher rates, earning 1% or less if they leave their cash in overnight US dollar bank accounts. Locking their savings away in a bank for a year will earn them approximately 2.5% on their money, as can be seen in the top chart of Figure 1. In contrast, institutional investors like Ninety One can access the wholesale deposit market (bottom chart of Figure 1). When we put cash on overnight deposit, we earn close to 5.3%, which is a big lift from what retail investors can get in their bank accounts. Conservative yield-seeking investors who have an investment horizon of at least 12 months, should consider investing in a global diversified income portfolio, such as the Ninety One Global Diversified Income Fund.

Figure 1: Firstly, what is available in dollar cash?



Source: bankrate.com and Bloomberg, April 2024.

Tapping into additional sources of income

Our recently launched Ninety One Global Diversified Income Fund, which is also available as a feeder fund, gives investors access to the higher income on offer across global fixed income assets. This global fixed income portfolio offers attractive dollar cash-plus returns for limited additional risk. We target a return of 1.5% above US dollar cash (gross of fees) over a rolling 12-month period, and no negative returns, also over rolling 12 months. By investing across global government debt, credit, and currency markets we are able to maximise income and diversify the portfolio to mitigate risk.

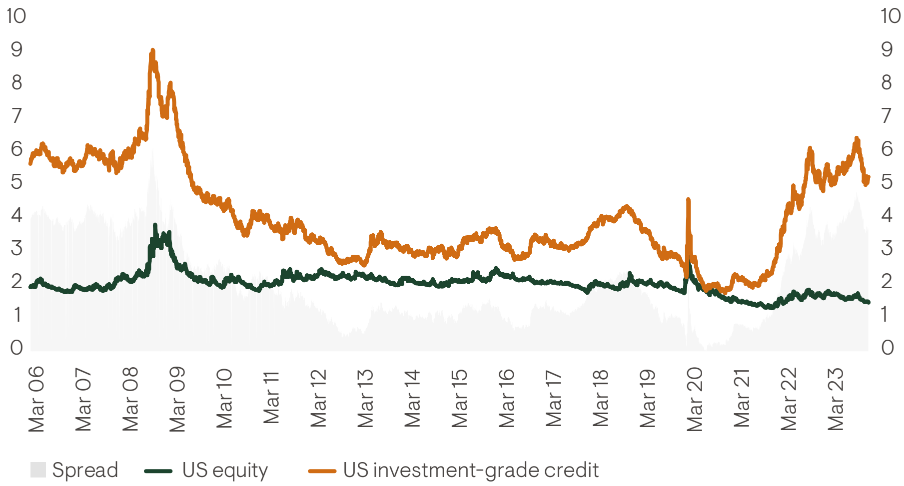
Policy divergence creating opportunities for investors

Markets have had to dial back their expectations on when the US Federal Reserve (the Fed) will kick off their rate-cutting cycle. We expect the absolute levels of yields to come down gradually over the next 12-24 months. In our view, the normalisation of global inflation will be the primary driver of rate cuts in developed markets, rather than economic growth concerns. Inflation in the US remains sticky and achieving the Fed's 2% target may prove to take longer than anticipated. Consequently, we have a very low duration risk to US government bonds. However, we have an overweight position in UK bonds as we think growth will be weak in the UK and inflation will also continue to surprise on the downside. We expect the Bank of England to have more rate cuts than consensus expectations currently show. With inflation 'better behaved' in the UK than in the US, we could see the Bank of England cutting rates before the Fed.

We believe a key reason why US core inflation will struggle to get back to the 2% target is the recent pick-up in real incomes. This can be attributed to higher wages and an increase in consumers' purchasing power due to a reduction in inflation. Higher consumer spending is keeping US growth relatively solid. With the US in an election year, there is also a risk of increased fiscal spending – on top of an already stretched budget deficit. And a Trump presidency will likely have an impact on global trade with the US dollar strengthening further.

Because markets have priced out interest rate cuts in the US, short-dated credit currently represents good value in terms of the yield on offer. This asset class is providing attractive risk-adjusted returns for investors in our fund. The top line in Figure 2 represents the absolute levels of income you can get in defensive US investment-grade credit relative to the dividend yields, for example, you would get in US equities currently.

Figure 2: Investment-grade credit offers an attractive risk-adjusted yield



Source: Bloomberg and Ninety One.

We have an overweight position in credit, with exposure to high-quality investment-grade credit. The average credit rating in the portfolio is BBB+.

A notable diversifier for the portfolio is our dollar exposure relative to the Japanese yen, driven by one of our core policy divergence themes in the portfolio. This is a very attractive way to reduce volatility in the portfolio through the correlation between the Japanese yen and short-dated US interest rates. We also have a short sterling position relative to a long position in the US dollar. Our currency positions reflect a more dovish central bank view from Japan and the UK, versus the Fed's more hawkish position.

Portfolio yield **6.04%**

Duration risk (yrs) **0.91**

Average credit rating **BBB+**

Source: Ninety One, as at 30 April 2024.

Conclusion

We believe the global backdrop remains attractive for investors seeking global defensive income. While we target a dollar cash-plus return for our investors, we remain firmly focused on diversification and reducing downside risks within the portfolio.

Important information

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