Global Managed Income

Market context

In September, financial markets defied history, delivering positive returns in what is historically a poor month. Initial turmoil, sparked by economic data from the US, Japan and China, shifted to optimism, driven by policy shifts. The US Federal Reserve (Fed) exceeded expectations with a 50bps cut, calming recession fears. China then announced a major stimulus package aimed at economic recovery, combining fiscal and monetary policies, including rate cuts by the People's Bank of China (PBoC) and steps to stabilise the property sector and boost consumption.

Global equities broke a four-year streak of September losses, delivering low-to-mid single-digit gains, with emerging markets outperforming developed ones. US equities posted the first September rise since 2019, driven by the Fed's easing and growing confidence in a soft landing. In contrast, European and UK equities ended lower, with slower-than-expected UK growth weighing on stocks. Japanese equities also fell amid weak economic data and political uncertainty. Chinese equities surged on government stimulus, with Hong Kong-listed stocks rising nearly 20%. Global high-yield corporate bonds gained as spreads narrowed, while a weaker US dollar boosted emerging market debt, particularly local currency bonds. Oil prices fell to US$71.77/bbl, their lowest level since early 2021, easing inflation fears and raising hopes for further central bank easing. Meanwhile, copper prices hit a 10-week high, boosted by China's economic support measures.

Developed market sovereign bonds gained in September, with US treasuries posting a fifth consecutive monthly advance – the longest streak since 2010. UK gilts delivered modest returns. Global investment-grade corporate debt performed well, supported by rate movements and spread compression. Elsewhere the Japanese yen strengthened against the US dollar, driven by divergent policy paths between the Fed and the Bank of Japan.

Gold continued its upward trend, reaching a new high of US$2,672.38/oz.

Performance

The Strategy delivered a positive return in US dollars, gross and net of fees*.

Equities added to returns, particularly our options and a small holding in Chinese equities, though stock selections slightly lagged the market. Government bonds benefitted from falling yields in developed and emerging markets, notably in the US, South Africa and Hungary. Other exposures also contributed positively to returns.

Fixed income exposure remained stable across sovereign bonds and corporate debt, while emerging market debt was increased slightly due to the potential for yields to fall in select regions. We prefer areas like South Africa, Colombia and Indonesia, where the market has not fully priced in expected rate cuts amid downward revisions in inflation and growth. Our duration was reduced, as we took profits from the month's rally, ending at 3.0 years. We see better opportunities outside the US, such as New Zealand and the UK, where rate expectations are less extended. The portfolio's credit quality remained A-rated on average.

Net equity increased but was managed cautiously, ending the month at c.19%. Equity options comprised almost half of our hedged equity exposure. Although consensus appears to be moving towards a soft-landing scenario and markets are pushing higher, in some cases to historically expensive levels, we believe downside risks and volatility remain elevated. Options allow us to navigate volatility, providing exposure to rising markets, while offering downside protection in falling markets by enabling us to cut risk quickly.

*Where performance is gross of fees, returns will be reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.

Not all securities held have been discussed. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Past performance does not predict future returns; losses may be made.

Outlook

Our outlook remains cautious not least because of the valuation of many pro-cyclical asset classes. While consensus favours a soft-landing scenario, downside risks persist. Tighter monetary policy has yet to feed through fully, and uncertainties, such as softening labour demand and potential geopolitical shifts, like a Trump presidency, could materialise. In Europe, tight policy and weak growth indicators elevate the risk of disinflation, and we expect rates to fall as inflation stabilises. In emerging markets, several central banks have cut interest rates, and while China has its own challenges in the near term, its policy appears loose, which may allow the Chinese economy to experience a more benign outcome than the bearish consensus suggests.

Overall, we believe this backdrop means we may see greater differentiation in asset class performance. While uncertainty is likely to continue for a while, particularly around the timing and magnitude of rate cuts, there are pockets of opportunity. There are assets that are attractively valued, offer good income sources, with less uncertainty, and are potentially more defensive in an economic downturn.

We believe a soft landing the US remains the most likely outcome; however, we have marginally increased the probability of a US recession given the elevated risks to the downside, and the portfolio is positioned accordingly – relatively cautiously.

We currently find most opportunities across government bond markets where yields are still elevated, and we see good value. Our exposure is split between the US and other high quality developed markets such as New Zealand, where the transmission of monetary policy into a slowing economy that requires lower rates seems clear. Generally, we see better value in emerging markets, where banks raised rates earlier, got inflation under control and have more investor friendly issuance trends. Ultimately, we see scope for larger rate cuts than the market currently expects, which should benefit higher quality fixed income returns in select markets.

The Strategy's duration reached a high of c.4 years earlier this year; we have recently taken profit into rallies, with duration reaching 3.0 years by the end of the of the month. However, we continue to utilise optionality and will look to add into weakness. We believe actively managing duration will be key to managing the environment ahead. Additionally, our fixed income exposure continues to be high quality on average (A).

Overall, growth-sensitive assets like equities and high-yield bonds offer limited risk premiums as valuations stretch. Our corporate bond exposure remains at all-time lows as the yields do not sufficiently reflect the risks; even short duration corporate bonds have the potential to drawdown significantly in risk-off environments.

Our physical equity exposure is at an all-time low of <10%. Within equities, we're identifying businesses that are successfully growing their earnings and passing on higher prices, particularly within the consumer staples sector. Overall, our positioning remains defensive, with a focus on resilient income, leaving us well placed to navigate the high inflation environment. Our equities typically feature low leverage, high profitability and strong pricing power. We believe in the persistence and growth potential of the income supporting our dividends. In addition, many resilient higher dividend equities are relatively attractively valued, which should support medium-term return potential.

Nearly half of our net equity exposure is in options, which provide a flexible way to hedge against economic uncertainties, while positioning us to capitalise on potential growth should a soft landing be achieved.

As the market backdrop continues to evolve, we maintain a cautious stance on equity and credit risk, while seeking opportunities in attractively valued, resilient income-generating assets with strong cash flows and return potential.

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