Global Diversified Income

Market context

US Treasury market yields ended a volatile quarter lower, with the 10-year yield falling 36bps to 4.2%. The main drivers were a weakening of global investor sentiment and a more uncertain outlook for the US economy; by quarter end, the market was pricing in c.75bps of interest rate cuts for 2025 – some 30bps higher than forecasts at the start of the quarter. The US Federal Reserve kept rates unchanged, with the 'dot plots' continuing to forecast two rate cuts in 2025. On the inflation front, there was a sharp rise in forecasts in March, with the University of Michigan survey showing the highest long-term outlook in over three decades. Global trade tensions escalated, with new tariffs imposed on China, Mexico, and Canada.

Elevated volatility was a key characteristic of European bond markets in the first quarter. Despite the European Central Bank cutting rates by 25bps in January and in March, bond yields rose significantly across the continent in response to a shift in fiscal dynamics, reflecting a rise in spending on defence. The spike in bond yields was most prominent in Germany; government moves to loosen fiscal rules drove up yields in all but the shortest-dated bunds, with the 10-year yield experiencing its largest daily rise since 1990.

In the UK, the Bank of England (BoE) cut its policy rate to 4.5% in February and held rates steady in March, citing a 'gradual and careful' policy approach. Inflation remained a concern, with headline CPI peaking at 3% in January before easing to 2.8% in February, though services inflation stayed elevated. As at the end of March, the market is pricing in around 50bps of cuts by the end of 2025, down from the c.60bps expected at the start of the year. Lower than expected gilt issuance for the upcoming fiscal year helped to alleviate concerns around the fiscal outlook somewhat. Overall, the risk-off tone in markets and dovish messaging from the BoE supported short-dated gilts, but longer-dated bond yields rose.

Japanese bond yields trended higher over the quarter. The Bank of Japan (BoJ) hiked rates in January to 0.5%, while persistent above-target inflation, encouraging initial results from this year's wage negotiations, and somewhat hawkish BoJ comments fuelled expectations of another rate hike later in the year. Yields peaked mid-quarter but stabilised in March along with other bond markets as US policy-induced growth concerns intensified.

Performance

The Fund delivered a positive absolute return, outperforming the overnight SOFR index.

The main driver of performance was the portfolio's positioning in government bonds, as yields moved lower over the quarter (bond prices rise when yields fall). Within government bonds, performance drivers included long positions in the UK and New Zealand as we continue to look for opportunities outside of the US market. We also took profit on the portfolio's European rates positions earlier in the quarter after yields fell.

Turning to the portfolio's credit exposure, although credit spreads widened (which negatively affected performance) the repricing in government bond yields and enhanced income provided by these positions offset this and added to performance overall. The portfolio was defensively positioned in credit products over the quarter, which helped to limit the impact of spread widening, and was diversified across an array of products with attractive value, including structured credit such as agency mortgage-backed securities and collateralised loan obligations.

On the currency side, positions held for portfolio protection detracted from performance over the quarter.

An analysis of the portfolio with reference to the extent to which it has or has not adhered to its policy objective.

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

Outlook and strategy

Our outlook has shifted more cautious over recent months as evidence of headwinds to the US growth outlook began to appear. Policy announcements from the new Trump administration are expected to tighten fiscal conditions and weigh on labour markets as uncertainty inhibits hiring across both the private and public sector. The Fed has moved towards a wait-and-see stance given the high level of uncertainty, which removes immediate support for risk assets from falling discount rates. We continue to see increasing risks to the downside for bond yields over the medium term, given how much rates have repriced, as well as the risks to US growth. Elsewhere, a nascent recovery in European activity may be underway, while Chinese stimulus is becoming more concerted - with authorities increasingly reversing course on key regulatory measures which had inhibited the private sector over the last few years, creating the potential for a more sustained upswing in growth. Many regional dynamics will ultimately be vulnerable to the US administration's next steps.

Outside of the US we believe central banks will continue delivering 'adjustment cuts' (i.e. reductions in nominal interest rates as inflation falls to prevent real policy rates from tightening further) but may need to react more aggressively if labour market weakness intensifies. This should remain supportive for front-end duration and steeper curves. With the slowdown in economic activity expected, we remain conservative on spread products. The credit portfolio remains invested in defensive short-dated investment-grade assets to avoid expensive valuations in longer-dated and high-yield credit, while finding opportunities in mortgage-backed securities (MBS) and structured credit to enhance yield in the portfolio.

Meanwhile, we still expect the market to remain focused on the narrative of higher neutral interest rates, as global yield curves continue to price in a higher level at which monetary policy is neither restrictive nor expansionary. This is due to a number of factors including larger structural fiscal deficits and higher government debt across the globe. In the US, recent releases of the Fed's Summary of Economic Projections (SEP) have shown members of the Fed revising their estimate of the long-run interest rate expectations higher.

We are also seeing a growing narrative building around US isolation, given the aggressive protectionist policies undertaken by the new US administration. As governments outside of the US focus on fiscal support to offset the negative impact of tariffs, we expect this will lead to further US dollar weakness as the narrative around US exceptionalism fades and investors look elsewhere for a store of wealth. We therefore continue to see opportunities across global fixed income markets outside of the US to enhance the portfolio's yield, while reducing our reliance on the US dollar as a portfolio hedge.

Important information

All information is as at 31.03.2025 unless otherwise stated. Where applicable, the distribution yield reflects the amount that may be expected to be distributed over the 12 months, as a percentage of the mid-market unit price of the Fund. The yield is not guaranteed, will vary over time and take no account of any preliminary charge. This communication is not for general public distribution and is for general information only. If you are a private investor and receive it as part of a general circulation, please contact us on +44 (0)20 7597 1800. The value of this investment, and any income generated from it, can go down as well as up and will be affected by changes in interest rates, exchange rates, general market conditions and other political, social and economic developments, as well as by specific matters relating to the assets in which it invests. The Fund's investment objective will not necessarily be achieved and there is no guarantee that these investments will make profits; losses may be made. This Fund may not be appropriate for investors who plan to withdraw their money within the short to medium term. Performance shown is that of the Fund and individual investor's performance may differ as a result of initial fees, actual investment date, date of any subsequent reinvestment and any dividend withholding tax. All the information contained in this communication is believed to be reliable but may be inaccurate or incomplete. Any opinions stated are honestly held but are not guaranteed and should not be relied upon. This is not a buy, sell or hold recommendation for any particular security. It is not an invitation to make an investment nor does it constitute an offer for sale. Before making an investment, please read the Prospectus and Key Investor Information Document, which sets out the fund specific risks and is available from Ninety One SA (Pty) Ltd ("Ninety One SA"). The portfolio may change significantly over a short period of time. The Fund is traded at the ruling price and can engage in borrowing, up to 10% of the portfolio net asset value to bridge insufficient liquidity, and scrip lending and may be closed in order to be managed in accordance with the mandate. The Fund is a sub-fund of the Investec Global Strategy Fund, which is a UCITS organised as a Société d'Investissement à Capital Variable under the law of Luxembourg. For further information on the Fund including application forms and a schedule of fees and commissions, please contact Ninety One SA. Fund prices and English language copies of the Prospectus, Report & Accounts and Articles of Incorporation and local language copies of the Key Investor Information Documents may be obtained from our website and free of charge from the following country specific contacts: Luxembourg – Investec Global Strategy Fund, 49 avenue J.F. Kennedy, L-1855 Luxembourg. In South Africa, Ninety One SA is an authorised financial services provider. Those sub-funds offered for public sale in South Africa are approved under the South African Collective Investment Schemes Control Act.

Indices

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