Diversified Income

Market context

Markets experienced a mixed fourth quarter in 2024, shaped by significant geopolitical and macroeconomic developments. The US presidential election, culminating in a Republican 'red sweep', was the key market event. While it initially boosted sentiment toward US assets, it also introduced considerable policy uncertainty. Concerns about inflation rose as macroeconomic data and Trump's proposed tariffs on imports signalled potential inflationary pressures.

Central banks maintained a cautious stance. The US Federal Reserve (Fed) delivered a final, hawkish 25bps rate cut in December, leading markets to recalibrate expectations for future easing. The European Central Bank (ECB) continued its 25bps cuts and downgraded its growth outlook amid weakening data, while the Bank of Japan (BoJ) held its policy rate steady at 0.25%. In China, the People's Bank of China (PBoC) signalled a shift toward a 'moderately loose' monetary policy for 2025, focusing on domestic demand growth, though a lack of specific measures tempered investor optimism.

Elsewhere, political turmoil in France resulted in a no-confidence vote and a Moody's ratings downgrade, while escalating tensions in the Middle East drove bouts of market volatility.

Against this backdrop, global equities delivered flat overall returns, reflecting the complexities of shifting central bank policies and geopolitical uncertainty. Beneath the surface, performance diverged significantly. Developed market equities outperformed emerging market equities, with market leadership narrowly concentrated. US equities posted low-single-digit returns, bolstered by strong performance following the US election. Mega-cap tech stocks held their ground, while small-cap stocks lost momentum as sentiment weakened after the Fed's hawkish shift. Meanwhile, European and Asian equities struggled under potential tariff risks, disappointing economic data, political uncertainties and diminished global risk appetite stemming from the Fed's signal of a slower pace of rate cuts. In contrast, Japanese equities outperformed, supported by a weaker yen.

In broader risk assets, global high-yield corporate bonds posted small negative returns, with Europe significantly underperforming in line with diverging economic trends. The US dollar strengthened as investors weighed the prospect of future tariffs and recalibrated Fed rate cut expectations. This, combined with fiscal challenges in key areas, negatively impacted emerging market debt, particularly local currency bonds. Finally, commodities delivered mixed results. Oil prices rose, driven by escalating geopolitical tensions and sharp reductions in US crude oil inventories, raising concerns about potential supply constraints. Conversely, industrial metals declined in line with other risk assets.

Defensive assets faced continued pressure during the quarter, with developed market sovereign bonds losing ground. Concerns over inflation weighed on US treasuries, driving a decline in their value. In Europe, government bond yields rose as global inflation fears linked to tariffs outweighed a weaker growth outlook. Similarly, UK gilts remained under pressure, with the 10-year spread over bunds reaching its widest level since 1990, following a fresh uptick in inflation reflected in November's CPI data. Investment-grade corporate bonds were also affected by rising rates, resulting in value declines. Meanwhile, the Japanese yen weakened against the US dollar as the Fed's stance contrasted sharply with the BoJ's dovish policy, reinforcing expectations that the interest rate differential between the two countries would persist.

Gold prices declined over the quarter following the US election, as uncertainty eased with the Republican 'red sweep'. Inflation concerns and stronger economic data led the market and the Fed to reassess the degree of further easing required in 2025. This drove the US dollar higher and pushed US treasury yields up, adding downward pressure on gold prices.

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.

Performance

The Strategy delivered a negative return in GBP, gross and net of fees[1].

Flat equity markets and weak bond markets weighed on returns. Higher-yielding equities underperformed, with our selections faring slightly worse. Government bond yields broadly sold off, particularly in emerging markets and the US, detracting from performance. However, a shorter duration exposure compared to earlier in the year, along with stronger performance in New Zealand, Canada and Germany provided some relief. Additionally, holding extra US dollar exposure offered a modest offset.

Portfolio activity

Within fixed income, exposure remained broadly stable across sovereign bonds and corporate debt. Duration was slightly reduced, ending the review period at 2.8 years. The lead-up to the US election introduced volatility and having benefitted from the rally in US sovereign bonds earlier, we further reduced duration, with nearly three-quarters now diversified outside the US. The portfolio remains high-quality and defensive, with an average rating of A. Our small net long position in the US dollar was broadly unchanged from the previous quarter.

Net equity exposure was actively managed within a cautious range of 11% to 25%, closing the period at approximately 11%. Following the US election, we increased the size of long equity options to capture potential market upside. These positions were subsequently reduced as equity markets softened after the Fed's December meeting, providing effective downside protection. By the end of the review period, equity options accounted for about one-third of our hedged equity exposure, reflecting our expectation of continued market volatility and uncertainty in the months ahead. In addition to equity options, we hold bond and FX options to safeguard against a broad range of potential outcomes.

Outlook

Our outlook remains neutral, balancing the risks around the consensus view of a soft-landing scenario. Investors are increasingly pricing in upside risks to US inflation and policy, partly influenced by the recent election of Trump and the Republican 'red sweep'. Trump's policy agenda will likely introduce disruption, but its precise impact remains uncertain. The Fed is expected to cut rates cautiously as it assesses the effects of Trump's policies, but we see downside risks given the extent of recent rate repricing. There is scope for more aggressive rate cuts in regions with greater economic weakness. Notably, Chinese policy easing could help limit downside growth risks, and we await further stimulus announcements given concerns over potential US tariffs on Chinese exports.

Uncertainty is likely to persist, particularly around policy and inflation risks and their implications for rate cuts. However, pockets of opportunity remain. Some assets offer attractive valuations, good income and defensive characteristics for an economic downturn. While we believe a US soft landing is the most likely outcome – supported by recent signs of economic resilience and post-election demand recovery – downside risks are elevated due to a softening labour market, restrictive interest rates and policy uncertainty. As a result, the portfolio maintains key defensive exposures while selectively adding risk.

Currently, we find the most value in government bonds, particularly in markets where yields remain elevated. A portion of our exposure is diversified away from the US and directed toward high-quality developed markets such as New Zealand and the UK. We also see opportunities in emerging markets, where earlier rate hikes, controlled inflation and investor-friendly issuance trends have improved conditions. With the scope for larger rate cuts than the market anticipates, select higher-quality fixed-income markets could benefit.

Duration peaked at approximately 4 years earlier this year, with profits taken during rallies, ending the period at 2.8 years - three-quarters diversified outside the US. We remain opportunistic, using optionality to add during periods of weakness. Actively managing duration will be critical in navigating the evolving environment. Our fixed-income exposure remains high quality on average (rated A).

More broadly, markets are priced for limited risks, and risk premia in growth-sensitive assets, such as equities and high-yield corporate bonds, remain minimal as valuations stretch further. US equity and credit market sentiment appears increasingly extended. Corporate bond exposure is at an all-time low, as yields fail to reflect sufficient risk compensation, with short-duration corporates also vulnerable to risk-off environments. Physical equity exposure is also at a record low of <10%. Within equities, we favour businesses demonstrating earnings growth and pricing power, particularly in the consumer staples sector.

---

[1] 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.

Our overall exposures remain defensive, with a focus on resilient income-generating assets. These typically exhibit low leverage, high profitability, and strong pricing power positioning us well for the inflationary environment. We have high conviction in the sustainability and growth potential of the income underpinning our holdings' dividends. Many higher-dividend equities remain attractively valued, supporting medium-term return potential. Approximately one-third of our net equity exposure is represented by equity options, offering a flexible way to hedge economic uncertainties while retaining the ability to capitalise on growth opportunities.

The continually evolving backdrop necessitates a nimble investment approach. We remain cautiously positioned in terms of equity and credit risk while seeking attractively valued, resilient income-generating securities with strong cash flow and return potential.

Specific risks.

Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. Default: There is a risk that the issuers of fixed income investments (e.g. bonds) may not be able to meet interest payments nor repay the money they have borrowed. The worse the credit quality of the issuer, the greater the risk of default and therefore investment loss. Derivatives: The use of derivatives may increase overall risk by magnifying the effect of both gains and losses leading to large changes in value and potentially large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss. Emerging market: These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems. Equity investment: The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. insolvency), the owners of their equity rank last in terms of any financial payment from that company. Interest rate: The value of fixed income investments (e.g. bonds) tends to decrease when interest rates rise.

Important information

This communication is provided for general information only. Nothing herein should be construed as an offer to enter into any contract, investment advice, a recommendation of any kind, a solicitation of clients, or an offer, marketing or solicitation with respect to any particular strategy, security, derivative, services or investment product. The information may discuss general market activity or industry trends and is not intended to be relied upon as a forecast, research or investment advice. The economic and market views presented herein reflect Ninety One's judgment as at the date shown and are subject to change without notice. Views and opinions presented herein will be affected by changes in interest rates, general market conditions and other political, social and economic developments. There is no guarantee that views and opinions expressed will be correct and may not reflect those of Ninety One as a whole, different views may be expressed based on different investment objectives. Although we believe any information obtained from external sources to be reliable, we have not independently verified it, and we cannot guarantee its accuracy or completeness. Ninety One's internal data may not be audited. Ninety One does not provide legal or tax advice. Reliance upon information in this material is at the sole discretion of the reader. Investors should consult their own legal, tax and financial advisor prior to any investments. Past performance should not be taken as a guide to the future. Investment involves risks; losses may be made.

Any decision to invest in strategies described herein should be made after reviewing the offering document and conducting such investigation as an investor deems necessary and consulting its own legal, accounting and tax advisors in order to make an independent determination of suitability and consequences of such an investment. This material does not purport to be a complete summary of all the risks associated with this Strategy. A description of risks associated with this Strategy can be found in the offering or other disclosure documents. Copies of such documents are available free of charge upon request.

This is not a buy, sell or hold recommendation for any particular security. Individual security performance does not represent the Strategy performance. There is no guarantee that the Strategy is currently investing and/or will invest in the securities in the future. The portfolio may change significantly over a short period of time. Forecasts are inherently limited and are not a reliable indicator of future performance.

In the US, this communication should only be read by institutional investors, professional financial advisers and their eligible clients, but must not be distributed to US persons apart from the aforementioned recipients. In Australia, this document is provided for general information only to wholesale clients (as defined in the Corporations Act 2001). For Funds within the Strategy that are registered for sale in Switzerland, copies of the Prospectus, latest annual and semi-annual Report & Accounts, Articles of Incorporation and Key Investor Information Documents may be obtained from the Swiss Representative and Paying Agent, RBC Investor Services Bank S.A., Esch-sur-Alzette, Zurich Branch, Bleicherweg 7, CH-8027 Zurich, Switzerland.

For distribution into Asia, this material should only be sent to professional investors, institutional investors and other qualified investors as defined by relevant local laws and regulations, and not to be distributed to the public or within a country where such distribution would be contrary to applicable law or regulations. It is strictly for the recipient's use only and should not be reproduced or distributed to any other persons without prior written consent from Ninety One. If you are not an intended recipient you must ignore this material and take no action based on the information in it. In Hong Kong, it is for professional investors only, issued by Ninety One Hong Kong Limited and has not been reviewed by the Securities and Futures Commission (SFC). In Singapore, it is for institutional investors only, issued by Ninety One Singapore Pte Limited (company registration number: 201220398M) and has not been reviewed by the Monetary Authority of Singapore. In the People's Republic of China (the "PRC"), it can be directed only at certain eligible PRC investors as prescribed by applicable PRC laws. In Taiwan, it is for professional institutional investors only. In Indonesia, Thailand, the Philippines and Brunei, it is for institutional investors and other qualified investors only. This material has been issued to you upon your request, without any marketing or solicitation activities conducted by Ninety One.

Except as otherwise authorised, this information may not be shown, copied, transmitted, or otherwise given to any third party without Ninety One's prior written consent. © 2025 Ninety One. All rights reserved. Issued by Ninety One.