



# Global Income Opportunities

## 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 sterling, gross and net of fees<sup>1</sup>, and underperformed its benchmark (45% MSCI World High Dividend Yield GBP Hedged + 55% BBG Global Aggregate TR GBP Hedged).

Q4 was a challenging quarter for the portfolio, as flat equity markets and weak bond performance weighed on returns. Higher-yielding equities underperformed, with our selections faring slightly worse. Government bond yields broadly rose, particularly in emerging markets and the US, detracting from performance. However, this was partially mitigated by a lower duration exposure compared to earlier in the year, as well as stronger performance in New Zealand, Canada and Germany. Additionally, holding some US dollar exposure provided a modest offset.

## Portfolio activity

Within fixed income, exposure was broadly stable across sovereign bonds and corporate debt. Our duration was marginally reduced, ending the review period at 2.9 years. We maintain a high-quality, defensive investment grade portfolio rated A+. Our small net long position in the US dollar was marginally reduced over the quarter.

Net equity was actively managed in a cautious range, ranging between 32% and 46%, before ending the month at c.32%. Our long equity options increased in size following the US election, enabling us to participate in market upside, and reduced in size as equity markets shifted lower following the Fed's meeting in December, helping to provide downside protection. At the end of the review period, equity options represented less than 10% of our hedged equity exposure as we continue to expect volatile and uncertain markets in the months ahead. In addition to equity options, we also have options in bonds and FX to help us protect against the range of 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 2.9 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

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<sup>1</sup> 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. Attribution is shown gross of fees. Fees are deducted at the portfolio level which is where their impact is shown. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

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.

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.

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