# Liontrust GF SF European Corporate Bond Fund: Q3 2022 review

Fund managers: Stuart Steven, Aitken Ross, Kenny Watson and Jack Willis

**The Fund returned -4.1%*† in euro terms over the quarter, compared with the -3.5% return from the Markit iBoxx Euro Corporates Index comparator benchmark.**

## Market backdrop

Financial markets came under significant pressure over the third quarter, despite an initially strong start. The combination of persistent inflation pressures and tightening monetary policy against a weakening economic growth outlook continued to fuel fears over the threat of recession.

The strong start to the quarter was driven by expectations for a dovish pivot by central banks following July's US CPI figure which came in below expectations, heightening optimism that inflation had peaked.

However, this momentum was short lived as central bankers responded forcefully, making it clear that their priority remains firmly on returning inflation to target levels through restrictive monetary policy. This view was re-enforced by inflation data coming in ahead of expectations over the remainder of the quarter.

As a result, 2022 continues to be one of the most challenging years since records began for bonds globally, with the world government bond index falling -21.3% year to date.

The US Federal Reserve ultimately delivered back-to-back 75bps rate hikes over the quarter, which, combined with the resolute hawkish commentary by Fed members, led to a rise in terminal rate expectations, driving treasury yields higher.

Meanwhile, the Bank of England also delivered consecutive 50bps interest rate hikes over the quarter. This likewise saw gilt yields move sharply higher, a move which accelerated aggressively in September following the announcement of the Government's mini-budget. The new Chancellor announced a considerable, larger than expected, unfunded fiscal package. The implication of a significant increase in government borrowing put further pressure on Gilt yields. The pound reached a new record low, falling 8.3% versus the US dollar over the quarter, amidst investor concern with the current government's credibility.

The size and the scale of the yield moves in the gilt market resulted in a collateral crisis in the UK pension fund market, particularly amongst liability driven investment funds. To avert further forced selling, the Bank of England intervened, pausing their quantitative tightening programme and buying long-dated gilts.

In Europe, the European Central Bank also began its rate hiking cycle during the quarter, with consecutive hikes totalling 1.25% during the period, in order to combat rising inflation which continues to be dominated by energy prices given its dependence on Russian energy.

This monetary tightening came in spite of a backdrop of further deterioration in economic data in the US, UK and Europe. Consumer confidence is at, or near, all-time lows; PMIs remain firmly in negative territory (in the UK and Europe); and a negative US Q2 GDP growth figure confirmed a technical recession.

## Fund review

The Fund's underweight duration positioning was a source of positive attribution through the quarter as government bonds sold-off. The Fund began the quarter 0.75 years underweight versus the benchmark, expressed through 10 and 30 year German Bunds. This underweight position peaked at 1.0 years during April, after we added short duration UK exposure.

Over the remainder of the quarter, we reduced the underweight position to finish at 0.25 years below benchmark duration. We believe yields have moved closer to their fair value, although we retain a small underweight as we think the ECB is behind the curve in its fight against inflation compared to the Fed and BoE.

The underperformance of the benchmark was driven by the Fund’s credit portfolio, which detracted from returns as corporate bonds continued to struggle over the quarter.

The Fund had a positive sector allocation, with a considerable contribution from its overweight positions in the banking and real estate sectors, but this was outweighed by negative stock selection. The poor stock-selection return came particularly from the insurance, banking sector and real estate sectors, where the Fund’s higher-beta names sit.

As with last quarter, the financials sector suffered from technical weakness and poor sentiment whilst the market remains in risk-off mode. However, we have conviction in our high-quality names, which should be relatively well positioned for current conditions owing to strong fundamentals and robust operating performance. Financials remain well capitalised with record high solvency rates and we believe their profitability should remain robust in a rising yield environment.

Fund trading activity in specific credits remained muted, with new corporate new issuances being sporadic due to volatile conditions, but also due to the relatively quiet period of the year. Despite this, we were able to add a couple of names at attractive new issue premiums and achieve a few relative value switches within specific names.

We added a new high coupon issue from Zurich Insurance Group, which came at a very attractive yield for a highly rated issuer. Zurich is a favoured name in our Fund, as the company has a strong competitive advantage from both a sustainability and a credit perspective. Solvency ratios are at record high levels, meaning the company is well capitalised to weather any financial headwinds and we expect it to be profitable in a high yield environment. We also participated in a new issue from British Telecom, which came at an attractive valuation. The position was funded by another holding from the company’s capital structure.

**Outlook**

The outlook remains challenging, with central bankers facing the difficult trade-off between raising interest rates to combat persistently high inflation and the impact this has on a deteriorating economic growth outlook. This more challenging economic outlook will undoubtedly impact corporate profitability.

The energy crisis remains an overhang for Europe. Fewer rate hikes are priced in for Europe compared to the UK and US, and we do not believe central bankers will be able to push for restrictive policy given the poor economic outlook.

Corporates maintain strong balance sheets and are well placed to weather an upcoming recession. A strong recovery from Covid has left corporates with healthy earnings and, while borrowing costs have risen, many have been able to refinance during the recent years of low rates. However, little economic growth is expected over the near term. Businesses will face growth challenges with falling real income and the higher cost of living, but we think our high-quality investment grade holdings are poised to weather any downturn.

In terms of interest rate positioning we are targeting active duration management rather than a large structural short, hence we have closed the duration short, moving to a neutral position with the flexibility to move long or short in future.

ey Features of the Liontrust GF SF European Corporate Bond Fund

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|---|---|
| **INVESTMENT OBJECTIVE & POLICY[1]:** | The Fund aims to maximise total returns (a combination of income and capital growth) over the long term (five years or more) through investment in sustainable securities, primarily consisting of European investment grade fixed income securities.<br><br>The Fund invests at least 80% of its assets in bonds issued by companies which are denominated in Euro or non-Euro corporate bonds that are hedged back into Euros. The focus is on investment grade corporate bonds (i.e. those which meet a specified level of creditworthiness). The Fund invests in companies that provide or produce more sustainable products and services as well as having a more progressive approach to the management of environmental, social and governance (ESG) issues.<br><br>Although the focus is on investment grade corporate bonds, the Fund may also invest in government bonds, high yield bonds, cash or assets that can be turned into cash quickly.<br><br>Where the Fund invests in non-Euro assets, the currency exposure of these investments will generally be hedged back to Euro. Up to 10% of the Fund's currency exposure may not be hedged, i.e. the Fund may be exposed to the risks of investing in another currency for up to 10% of its assets.<br><br>The Fund may invest both directly, and through the use of derivatives. The use of derivatives may generate market leverage (i.e. where the Fund takes market exposure in excess of the value of its assets).<br><br>The Fund has both Hedged and Unhedged share classes available. The Hedged share classes use forward foreign exchange contracts to protect returns in the base currency of the Fund. |
| **RECOMMENDED INVESTMENT HORIZON:** | 5 years or more |
| **SRRI[2]:** | 4 |
| **ACTIVE / PASSIVE INVESTMENT STYLE:** | Active |
| **BENCHMARK:** | The Fund is considered to be actively managed in reference to IBOXX Euro Corporate All Maturities (the "Benchmark") by virtue of the fact that it uses the benchmark(s) for performance comparison purposes. The benchmark(s) are not used to define the portfolio composition of the Fund and the Fund may be wholly invested in securities which are not constituents of the benchmark. |
| **SUSTAINABILITY PROFILE** | The Fund is a financial product subject to Article 9 of the Sustainable Finance Disclosure Regulation (SFDR). |

Notes: [1]As specified in the KIID of the fund; [2] SRRI = Synthetic Risk and Reward Indicator. Please refer to the KIID for further detail on how this is calculated.

**Discrete years' performance*, to previous quarter-end:**
**Past performance does not predict future returns**

| | Sep-22 | Sep-21 | Sep-20 | Sep-19 |
|---|---|---|---|---|
| Liontrust GF Sustainable Future European Corporate Bond A5 Acc EUR | -16.9% | 2.8% | -0.5% | 4.9% |
| Markit iBoxx Euro Corporates Index | -16.1% | 1.6% | 0.2% | 6.1% |

*Source: FE Analytics, as at 30.09.22, A5 share class, in euros, total return (net of fees and income reinvested). Discrete data is not available for 10 full 12-month periods due to the launch date of the portfolio.

For a comprehensive list of common financial words and terms, see our glossary at:
liontrust.co.uk/benefits-of-investing/guide-financial-words-terms