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Global Fixed Income

May 2024 review

Liontrust GF Strategic Bond Fund

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The Liontrust GF Strategic Bond Fund returned 2.0%* in US dollar terms in May. The average return from the EAA Fund Global Flexible Bond (Morningstar) sector, the Fund's reference sector, was 0.9%.

Market backdrop

May saw a softening in economic data after the strong momentum and overshoots that had been the theme of the first quarter of 2024. It is too early to say definitively that the US economy's growth is slowing; we will need to see more confirmatory data. The advance indicators point towards further heat coming out of the labour market - services inflation has remained sticky but is a lagging indicator. Sometime later in 2024 the conditions will be in place for the Federal Reserve to start cutting rates. Once it embarks on its easing cycle, we expect cuts to be larger than the market is pricing in as the Fed moves rapidly towards a more neutral stance with Fed funds rates in the 2% - 3% vicinity.

Focussing on the inflation data, April's US consumer price inflation (CPI) data bucked the trend of acceleration seen in the first quarter of the year. Services inflation remains far too high for the Federal Reserve's comfort and interest rates will be kept at their current restrictive levels until further progress has been made. However, the data showed enough encouraging signs to be able to rule out any further rate hike unless there is a significant change in economic momentum. Thus, "high for longer" remains the current US rates backdrop, but "higher" is off the table.

Services inflation remains as the stickly last leg of the inflationary battle. There was a little bit of good news in April with the monthly rate falling to 0.4% compared to 0.5% in March. Splitting services into two parts is informative: firstly there is shelter which was up 0.4% in April and 5.5% over the last year. The run rate of rental inflation went down to 0.35%, with owners' equivalent rents at 0.42%; these two data series continue to have a significant lag to current market rents and inflationary rates should gradually ease over the coming quarters. Secondly, there is core services ex housing, which is referred to as "supercore" services inflation. April's 0.42% increase in supercore inflation is still far too high for comfort, but down from 0.65% in March; the annual rate has ticked up to 4.91%. A significant minority of the monthly increase was due to a continued surge in motor vehicle insurance; it was up 1.8% in April, taking the annual rate to 22.6%. Pressure here will continue for a few months as insurers continue to get approval to push through increases in premia, but this is just playing catch up as the underlying costs of cars and repairs/maintenance have long since stabilised. Outside of the minutiae, supercore services inflation is highly correlated to nominal wage inflation. This is why the Federal Reserve wants to see further softening in the US labour market to conquer this last inflationary leg.

Progress on Eurozone inflation stalled during May, driven both by some one-offs and continued sticky services inflation. German inflation was 0.1% above expectations at 2.8% and up 0.4% from the prior month. The majority of the change emanates from the timing of Easter and base effects in transportation where there have been previous subsidies; after adjusting for idiosyncrasies the data are indicative of a need for further progress in tackling services inflation. The aggregated Eurozone consumer price was also above expectations; headline inflation was 2.6% with core CPI at 2.9%. Some of the overshoot was due to a one-off with a change to French GP reimbursements adding 5-10bps to core CPI. Services inflation was worrisome at 4.1%, a jump of 0.4% in the annual rate compared to April. Some of this was due to the aforementioned Easter timing, base effects, and French calculation changes. However, it will still cause consternation amongst the more hawkish ECB officials.

Given the differing inflation outcomes during the month, US Treasuries made up some lost ground against Bunds. The spread between the two contracted by 25 basis points during May, reversing the underperformance of US Treasuries seen in late March and April and taking the relationship back within a more normal range. While we currently prefer US duration exposure over European, albeit we like both, this could evolve as the year progresses and we approach the US election with its associated risks.

Fund positioning and activity

Rates

Toward the end of May with bonds look tactically oversold we made a small increase to our strategic long duration position in the Fund. Exposure is now 7.75 years split between 3.3 years in the US, -0.5 years in Canada, 1.0 years in New Zealand, 2.5 years in the Eurozone, and 1.45 years in the UK. We continue to prefer short-dated and medium-dated bonds. The net duration exposure in the 15+ year maturity bucket is zero.

Allocation and selection

The larger change to positioning during May was a further reduction in credit exposure. High yield exposure was lowered through both trimming various holdings and outright sales of subordinated bonds issued by Vodafone and Heimstaden Bostad. While the yield on corporate bonds is very attractive, most of this is coming from the underlying government debt being cheap; at overall index levels credit spreads are priced for perfection. We do not want to sacrifice too much yield by being underweight in our credit exposure so have reinvested proceeds in short dated high quality investment grade bonds such as AbbVie 11/2024 maturity US dollar debt. We also continue to like the yield on very short-dated US Treasuries and use bond futures to manage the Fund's overall duration.

Net high yield exposure is now below our 20% neutral level at 15%; the weighting in bonds is 24.2% and there is an 9.1% risk reducing overlay. The Fund has 38.3% exposure to investment grade credit, which is below our 50% neutral level.

This underweight position in credit gives the Fund a lot of risk budget to buy once credit spreads widen. We are targeting adding exposure to corporate bonds during a period of volatility as opposed to anticipating a significant uplift in defaults and the permanent destruction of capital.

Discrete years' performance (%) to previous quarter-end**:

	Mar-24	Mar-23	Mar-22	Mar-21	Mar-20
Liontrust GF Strategic Bond B5 Acc	7.7%	-3.9%	-4.0%	13.2%	-0.4%
EAA Fund Global Flexible Bond - USD Hedged	7.4%	-3.2%	-3.1%	12.7%	-1.9%

**Source Financial Express, as at 31.05.24, total return, B5 share class. Discrete data is not available for ten full 12-month periods due to the launch date of the portfolio (13.04.18).*Source: Financial Express, as at 31.03.24, B5 share class.

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

Key Features of the Liontrust GF Strategic Bond Fund

Investment objective & policy[1]	The investment objective of the Fund is to maximise total returns over the long term through a combination of income and capital. The Fund will seek to achieve its objective by investing in bond and credit markets worldwide. The Fund invests in a wide range of bonds issued by corporates and governments, from investment grade through to high yield. The Fund invests in developed and emerging markets, with a maximum of 40% of its net assets invested in emerging markets. Investments may be made in "hard" currencies, such as US Dollar, Euro and Sterling, and up to 25% of the net assets of the Fund may be invested in soft currencies, such as those of emerging markets. Where the Fund invests in non-US Dollar assets, the currency exposure of these investments will generally be hedged back to US Dollar. 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. 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). In addition, the Fund may invest in cash or cash equivalents, such as deposits and Money Market Instruments, for cash management purposes. Within the limits stated above, there are no geographical or economic sector restrictions on the Fund's investments. 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. The fund manager considers environmental, social and governance ("ESG") characteristics of issuers when selecting investments for the Fund.
Recommended investment horizon	5 years or more
Risk profile (SRI)[2]	3
Active/passive investment style	Active
Benchmark	The Fund is actively managed without reference to any benchmark meaning that the Investment Adviser has full discretion over the composition of the Fund's portfolio, subject to the stated investment objectives and policies.
Sustainability profile	The Fund is a financial product subject to Article 8 of the Sustainable Finance Disclosure Regulation (SFDR).

Notes: 1. As specified in the PRIIP KID of the fund; 2. SRI = Summary Risk Indicator. Please refer to the PRIIP KID for further detail on how this is calculated.

Key Risks

Past performance does not predict future returns. You may get back less than you originally invested. We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

The fund manager considers environmental, social and governance ("ESG") characteristics of issuers when selecting investments for the Fund.

Bonds are affected by changes in interest rates and their value and the income they generate can rise or fall as a result;

The creditworthiness of a bond issuer may also affect that bond's value. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may have difficulty in paying their debts. The value of a bond would be significantly affected if the issuer either refused to pay or was unable to pay.

Overseas investments may carry a higher currency risk. They are valued by reference to their local currency which may move up or down when compared to the currency of the Fund.

The Fund can invest in derivatives. Derivatives are used to protect against currency, credit or interest rate moves or for investment purposes. There is a risk that losses could be made on derivative positions or that the counterparties could fail to complete on transactions.

The Fund uses derivative instruments that may result in higher cash levels. Cash may be deposited with several credit counterparties (e.g. international banks) or in short dated bonds. A credit risk arises should one or more of these counterparties be unable to return the deposited cash.

The Fund invests in emerging markets which carries a higher risk than investment in more developed countries. This may result in higher volatility and larger drops in the value of the fund over the short term.

The Fund may encounter liquidity constraints from time to time. Participation rates on advertised volumes could fall reflecting the less liquid nature of the current market conditions.

Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

Disclaimer