



Quarterly Outlook – Fixed Income

DOVISH TONE MARKS THE RETURN OF MONETARY EASING

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KEY INSIGHTS

- While investors are pricing in multiple interest rate cuts on both sides of the Atlantic, we believe market expectations have become too extreme.
- Global economic growth data appears close to bottoming, and we should see improvement in the second half of 2019.
- The growth backdrop will be critical for the performance of different classes.

MARKETS PRICING IN RATE CUTS

The period of quantitative tightening has come to an end. Fixed income markets have now entered a new regime whereby major central banks are expected to ease monetary policy. This has triggered a significant rally in core government bonds with multiple rate cuts not only in the U.S. but also in the eurozone now priced in by markets. However, we believe that the markets' pricing of monetary easing has potentially become too extreme and are sceptical over the ability of U.S. Treasuries and German bunds to continue rallying. This led us to reduce the portfolio's duration during June.

A BOTTOMING IN GROWTH DATA

On the global growth front, we believe that data is close to bottoming and it's possible we will see some improvement in the second half of 2019. Looser financial conditions should be supportive of growth, as should the reduction in uncertainty owing to China and the U.S. resuming trade talks. We believe this environment could be conducive for risk assets, particularly emerging markets, which continue to stand out in terms of improving fundamentals and attractive valuations. As a result, we have been adding to select high-carry opportunities in developing currencies in recent weeks.

On the bond side, we have added positions in local markets where inflation is well behaved and there's potential for the central bank to cut interest rates in the future. To keep risk balanced in the portfolio, we have increased our short bias against credit markets because valuations look expensive after rallying strongly late in the quarter. In addition, the short credit position should help provide some protection should growth slow further.

ANTICIPATING U.S. DOLLAR WEAKNESS

In the currency sphere, short positioning in the U.S. dollar continues to play a key role in the portfolio's construction. After multiyear strength, we believe the U.S. dollar should finally start to weaken as the period of U.S. economic exceptionalism has come to an end and Federal Reserve interest rate cuts will serve to narrow the U.S. interest rate differential with other countries, reducing the dollar's appeal.

The trend of both core government bonds and risk markets rallying at the same time is unlikely to last, in our view. How global growth evolves over the next few months will be critical for the performance of different classes with any stabilisation potentially putting core government bonds under pressure, while further signs of a slowdown could leave risk markets, such as equities, vulnerable to a correction. Against this backdrop, monitoring economic data releases closely will continue to be important as we look for signs on the health of the global economy. Our role is to continue to offer a diversification alternative to our clients while generating sustainable income and to minimise drawdowns when some of our positions underperform.

RISKS

The following risks are materially relevant to the portfolio.

China Interbank Bond Market risk – market volatility and potential lack of liquidity due to low trading volume of certain debt securities in the China Interbank Bond Market may result in prices of certain debt securities traded on such market fluctuating significantly.

Country risk (China)- All investments in China are subject to risks similar to those for other emerging markets investments. In addition, investments that are purchased or held in connection with a QFII licence or the Stock Connect program may be subject to additional risks.

Country risk (Russia and Ukraine)- In these countries, risks associated with custody, counterparties and market volatility are higher than in developed countries.

Credit risk- A bond or money market security could lose value if the issuer's financial health deteriorates.

Currency risk- Changes in currency exchange rates could reduce investment gains or increase investment losses.

Default risk- The issuers of certain bonds could become unable to make payments on their bonds.

Derivatives risk- Derivatives may result in losses that are significantly greater than the cost of the derivative.

Emerging markets risk- Emerging markets are less established than developed markets and therefore involve higher risks.

High yield bond risk – a bond or debt security rated below BBB- by Standard & Poor's or an equivalent rating, also termed 'below investment grade', is generally subject to higher yields but to greater risks too.

Interest rate risk- When interest rates rise, bond values generally fall. This risk is generally greater the longer the maturity of a bond investment and the higher its credit quality.

Issuer concentration risk- To the extent that a portfolio invests a large portion of its assets in securities from a relatively small number of issuers, its performance will be more strongly affected by events affecting those issuers.

Liquidity risk- Any security could become hard to value or to sell at a desired time and price.

Prepayment and extension risk- With mortgage- and asset-backed securities, or any other securities whose market prices typically reflect the assumption that the securities will be paid off before maturity, any unexpected behaviour in interest rates could impact fund performance.

Sector concentration risk- The performance of a portfolio that invests a large portion of its assets in a particular economic sector (or, for bond funds, a particular market segment), will be more strongly affected by events affecting that sector or segment of the fixed income market

General Portfolio Risks

Capital risk- The value of your investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the portfolio and the currency in which you subscribed, if different.

Counterparty risk – an entity with which the portfolio transacts may not meet its obligations to the portfolio.

Geographic concentration risk- To the extent that a portfolio invests a large portion of its assets in a particular geographic area, its performance will be more strongly affected by events within that area.

Hedging risk- A portfolio's attempts to reduce or eliminate certain risks through hedging may not work as intended.

Investment portfolio risk- Investing in portfolios involves certain risks an investor would not face if investing in markets directly. **Management risk**- The investment manager or its designees may at times find their obligations to a portfolio to be in conflict with their obligations to other investment portfolios they manage (although in such cases, all portfolios will be dealt with equitably). **Operational risk**- Operational failures could lead to disruptions of portfolio operations or financial losses.

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