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# LO Funds

## TargetNetZero Global IG Corporate

### Newsletter

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Sustainable Fixed Income • Fixed Income

31 August 2024

#### OVERVIEW OF THE FIXED INCOME MARKET

After a sharp risk off drawdown to begin the month, fixed income recovered markedly to record a second successive month of strong performance in August. Return drivers varied across geographies, with high yield outperforming in Europe, whereas US saw more upside from duration, albeit also alongside compressing spreads. However this differential between regions was actually driven by EUR HY real estate, which saw massive outperformance. Outside of this, performance across regions in the credit space was more comparable.

Markets were violently jolted at the start of the month as a brutal carry unwind saw risk on carry positive positions upended. The exact trigger is debatable but the sell off was initially started following the Bank of Japan's hawkish rate hike, and then sent into overdrive by a very weak US labour market report. The latter saw a sharp increase in pricing of the speed and magnitude of the impending cutting cycle by the Federal Reserve, at one point pricing as much as 75bps of cuts by the September meeting, including an emergency cut. The sharp move rocked the popular USD vs JPY carry trade, spilling over into wider carry positive trades as unwinding accelerated. A natural loser of the carry unwind was short volatility positions, exemplified by the VIX which suffered a record intraday increase.

However, this carry unwind induced risk off episode was ultimately extremely short lived, with risk assets reversing intraday around a stronger than expected ISM services report, which reintroduced some perspective that the US economy wasn't dropping off of a cliff edge. This ultimately began a reversal in risk markets which was almost as swift as the initial shock. Credit spreads recovered entirely within a matter of days and continued to cyclical tight. Rates however largely held their gains despite some repricing of very front-end expectations after the overshoot. The diversifying nature of rates against credit was a welcome reminder to focus on the macro picture through such nature and that with growth now more in focus than inflation, duration has the potential to once again play an important role in portfolios as cuts progress.

On the macro picture, it was ultimately a continuation again of the recent trend, inflation continues to lose steam and return to target levels led by goods disinflation, but also slowing services. On the other hand, growth is trending lower but remaining robust, whilst labour markets are correcting to more natural levels. The triggering of the Sahm rule in the US labour market was a key focus of concern for recession signaling, but in reality, the move higher in the unemployment rate has come from increased labour supply rate than layoffs. Whilst this trend continues, marginally higher unemployment cannot be taken as an imminent recession signal.

This broad picture was affirmed by Fed chair Powell when speaking on the back of the Jackson Hole summit, confirming that he now sees it as time to lower rates, and that the speed and magnitude will spend on incoming data. His clear emphasis on the labour market now being the number one priority for the Federal reserve marks a clear shift in focus and should mean inflation data can take somewhat of a backseat in coming months, assuming no sudden sharp exogenous shock.

#### PORTFOLIO ACTIVITY

Enstar is a US based global leader in non-life run-off insurance books management. The announcement of a take-private transaction by PE consortium provoked a sharp selloff driven by concerns around the potential new ownership structure. We felt the sell-off was overdone, especially as both Fitch and S&P had affirmed the ratings at BBB+ with a stable outlook post transaction and took the opportunity to invest further in the bonds at attractive levels.

#### PERFORMANCE AND CHARACTERISTICS

The fund out-performed its benchmark again in August driven by a positive contribution from our overweight in both EUR & USD BBB rated issuers. At the sector level, EUR Real Estate & USD Bank & TMT holdings contributed strongly with our holding in German Residential property company Grand City continuing to perform very well.

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The strong year to date out-performance reflects the overweight in the BBB rating space in both USD & EUR as well as the underweight in USD "A" rated issuers. Our relative overweight in subordinated hybrid securities, particularly in EUR real estate and USD Financials and TMT, has also performed well this year.

**OUTLOOK**

The events of the month reinforced rather than questioned our stance on fixed income, with a preference for duration remaining intact. We acknowledge increasing risks from diverging monetary policy backdrop and increased political uncertainty, but also take comfort in the swift recovery in credit markets following the carry unwind, underlining the appetite for credit remains strong and real money participants have sufficient cash to deploy to take advantage of buying opportunities. We remain focused on core fundamental trends, which as of now show slowing, but not collapsing demand, with earnings continuing to come in robust, albeit at slower growth rates the previous quarters.

**SUSTAINABILITY**

Date set for public hearings at the International Court of Justice which could help define countries' legal obligations to fight climate change:

The top United Nations court announced that public hearings will open on 2 December in a landmark case seeking a non-binding advisory opinion on "the obligations of States in respect of climate change."

The UN court's panel of 15 judges from around the world will seek to answer two questions: what are countries obliged to do under international law to protect the climate and environment from human-caused greenhouse gas emissions; and what are the legal consequences for governments where their acts of lack of action have significantly harmed the climate and environment? The court said it had received written comments from 62 nations and organisations including the EU, UK, US and Brazil in regard to the case.

**PERFORMANCE**

30.08.2024	INCEPTION	AUM	MONTH-TO-DATE	YEAR-TO-DATE	INCEPTION-TO-DATE	5 Year Ann. Return	10 Year Ann. Return
LO Funds TargetNetZero Global IG Corporate Syst Multi Ccy Hdg USD NA	26.04.2021	USD 194 mn	1.45%	4.62%	-3.26%		
Bloomberg Barclays Global-Aggregate-Corporate (Hdg USD)			1.19%	3.69%	-1.35%		

Past performance is not a guarantee of future results. Performance is presented net of fees. AUM as of the date of the table.

This landmark climate case follows a the UN tribunal on maritime law in May, which said that carbon emissions qualify as marine pollution and countries must take steps to mitigate and adapt to their adverse effects.

China has cut new coal power plant permits by nearly 80%:

China is the world's largest builder of coal-fired power stations, yet a new report shows that they cut the number of permits for new plants by nearly 80% in the first half of 2024, indicating that they may be reaching a turning point on coal.

A review of project documents by Greenpeace East Asia found that 14 new coal plants were approved from January to June with a total capacity of 10.3 gigawatts, compared with 50.4 gigawatts in the first half of 2023.

Analysts at the Helsinki-based Centre for Research on Energy and Clean Air believe China's carbon emissions may have peaked in 2023, after reporting that emissions fell 1% year-on-year in the second quarter of 2024.

EU outlines the benefits of multi-billion-euro environmental action:

The EU's flagship environmental protection scheme has improved the conservation status of 435 species while cutting greenhouse gas and nitrogen oxides (NOx) pollution, producing a tenfold return on the ?3.46 billion invested in the seven years to 2020, the European Commission has claimed in a review of the last budget period.

The LIFE programme is the only European instrument which directly funds environmental action on the ground, supporting +1,100 projects from 2014 to 2020. These projects ranged from 'traditional' conservation projects to supporting policy makers in redesigning the EU emissions trading system, which sets a cap for industrial carbon emissions.

Budget allocation to LIFE has been increased to ?5.4bn for the current seven-year period to 2027.

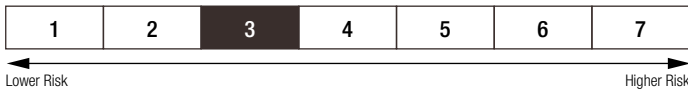
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The following risks may be materially relevant but may not always be adequately captured by the synthetic risk indicator and may cause additional loss:

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Before taking any investment decision, please read the latest version of the

prospectus, the articles of incorporation, the Key Information Documents (KIDs) and the latest annual report and semi-annual report. Please pay attention to the Appendix B "Risk Factors Annex" of the prospectus.

Incorporation of extra-financial risks into the investment decision process may result in underweighting of profitable investments from the sub-fund's investment universe and may also lead the management of the sub-fund to underweight investments that will continue to perform. Sustainability risks may lead to a significant deterioration in the financial profile, profitability or reputation of an underlying investment and may therefore have a significant impact on its market price or liquidity.

The Fund has been classified as a financial product subject to Article 8 of Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial sector (the "SFDR"). The Fund promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices.

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The articles of association, the prospectus, the Key Information Document ("PRIIPS/KIDs"), and the subscription form are the only official Offering Documents of the Fund's shares (the "Offering Documents"). No party is authorised to provide information or make assurances that are not contained in the Offering Documents.

### Access to documents in country of registrations:

The PRIIPS/KIDs are available in one of the official languages of your country and a Prospectus is available in English, French, German and

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**Finland:** Finanssivalvonta (Fiva) - Financial Supervisory Authority (FIN-FSA), Snellmaninkatu 6, P.O. Box 103, FI – 00101 Helsinki, Finland; Website: <http://www.finanssivalvonta.fi>.

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**Liechtenstein.** Representative, LGT Bank AG Herrengasse 12, 9490 Vaduz, Supervisory Authority: Finanzmarktaufsicht Liechtenstein ("FMA").

**Luxembourg:** Commission de Surveillance du Secteur Financier (CSSF), 291, route d'Arlon, L-1150 Luxembourg; [www.cssf.lu](http://www.cssf.lu).

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