

# LO Funds

## Global Climate Bond

### Newsletter

Sustainable Fixed Income • Fixed Income

31 October 2024

#### MARKET UPDATE

Impact bond issuance continued with the same strong pace as the previous month, and slightly ahead of same period last year. We saw some repeat issuers return to market, such as Swedbank, SEB, Nordea, Iberdrola, HIME and EnBW. We also continued to see issuance out of China from Wuhan Metro, China Construction Bank, Zhengzhou Metro and China Power. There was also some notable sub investment grade issuance from Iliad, a European telecommunication provider who brought a long 5 year green bond denominated in euros which attracted a strong order book.

Market participants were left re-evaluating the trajectory of rate cuts as US Treasury yields rose and bond prices ticked lower as robust economic dampened hopes of another large cut. In addition to speculation that the Fed will assume a more measured approach, investors digested the economic impact of the continued conflict in the Middle East and strikes at East Coast ports. Spreads remained resilient despite the elevated rate volatility.

In the Eurozone, markets shifted focus to the increased probability of a Trump victory, and concerns around the imposition of US import tariffs. In addition to US macro uncertainty, investors were concerned over the possibility of lower neutral rates, based on the weak investment outlook, high household savings and fiscal policies gradually turning restrictive. Elsewhere, in Japan the focus remains on the election, BoJ rate hike expectations, and domestic economic activity.

#### PORTFOLIO POSITIONING

The fund underperformed the benchmark over the month (0.47% vs. 0.62%), bringing the since inception return of the portfolio to 0.57% vs. 0.50% for the benchmark. The underweight duration position and security selection in US dollar denominated bonds proved beneficial to relative performance, but these were partially offset by positioning along the curve. The overweight positions in Australian dollars, Malaysian Ringgit, and Norwegian Krone were all significant negative contributors to relative performance as the US dollar strengthened over the month.

In weighted duration terms, we are underweight the dollar bloc,

underweight Asia, and In bond market terms, we are slightly underweight the dollar bloc, underweight Asia, and overweight Europe. The fund's overall underweight duration position is focused predominantly in China, given the low level of yields in a global context and recent growth supportive economic measures. The fund is also slightly underweight US believing that the US economy is likely to remain more resilient than market expectations and as such result in higher yields.

Within Europe, we hold small overweight positions in the Norwegian krone, Swedish krona, and UK Sterling denominated bond markets. Within Asian bond markets, we are predominantly underweight China. Within the dollar bloc, we are overweight the Canadian bond market relative to the US. We currently hold an overweight position in Malaysian Ringgit, Norwegian Krone, Mexican Peso, and Australian dollars relative to US dollars, although the latest position was halved in size during the period.

Also during the month we neutralised our underweight duration and reduced our steepener position in Japan, given the sustained yield rises that have been seen as the BOJ returns to monetary policy normalisation, as well as the expectation that JGB issuance next year will be front loaded at the short end of the curve.

We took the opportunity to purchase new bonds on the primary market from Romania, Credit Mutuel Arkea and Iliad. The latter is a European telecommunication provider, with the proceeds of this security going towards energy efficiency, circular economy, clean transportation and renewable energy related projects.

We also utilised the secondary market to add more green corporate bonds in US dollars, issued by LG Energy and Alexandria Real Estate.

#### CONTRIBUTORS

- Underweight duration position in US dollar denominated bonds
- Security selection in US dollar denominated bonds
- Small underweight position in euro

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## DETRACTORS

- Overweight position in Australian dollars
- Overweight position in Malaysian ringgit and Norwegian Krone
- Curve positioning in US dollar denominated bonds

Our forward-looking expectations have not changed materially, in that we view a soft landing in the US as a base case, we see relatively weaker growth in Europe and we expect gradual tightening in Japan and easing from China. What has changed is levels of rate expectations exacerbated by an out of consensus 50 bps Fed Cut in September. With most major central banks in easing mode predicated on the belief that inflation levels and forecasts are within their projected models central bankers feel more comfortable with less restrictive monetary policies. Given the FED easing and China's recent commitment to their growth targets our confidence in a soft landing has increased.

We continue to believe the current levels of yields represent a marginal mispricing in interest rate expectations in the near term.

To take advantage of an increased level of confidence in a soft landing we feel more comfortable using the primary market to add to some lower rated investment grade issuers. We do this believing that spreads will behave relatively well given the renewed investor confidence in the so called, "Fed Put." Given the dramatic moves in rates and curves and

a still significant US election on the immediate horizon we will look to add duration when rates drift higher on better data days. Our Japanese rate position has rightly been short duration for some time, and while we still believe rates can go higher, we view the steepness of the curve as an opportunistic time to flatten out our yield curve exposure, which is also yield and carry supportive. Given China's new efforts to stimulate and meet their growth targets we will maintain an underweight duration position in China.

Political uncertainty and upheaval has proved to be a key theme in H1 2024. Investors are increasingly turning their attention to what is predicted to be a volatile US election period later in the year. We are looking to exploit macro themes and trends that we believe are likely to play out regardless of who enters the White House, including continued nearshoring of supply chains and aversion to China. One of the ways to exploit this is to maintain exposure to Malaysia and look to potentially add in other regional currencies.

New funding requirements have produced the environment for a resurgence of issuance as we move through 2024. Due to market expectations of more interest rate cuts this year, there has also been a significant amount of demand to absorb this supply. We expect a continuation of strong levels of issuance heading into the final part of the year, as the market is on track to surpass peak levels seen in 2021, with a higher proportion of green bonds now being issued relative to social or sustainability bonds.

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