
LO Funds

Global Climate Bond

Newsletter

Sustainable Fixed Income • Fixed Income

30 November 2024

MARKET UPDATE

Despite economic uncertainties and geopolitical risks, impact bond issuance demonstrated resilience last month. November marked the quietest month for the European impact bond market in five years, with financial issuance significantly down year-on-year, primarily due to the lack of covered bonds. Nonetheless, we remain on track for another record year, largely fuelled by a surge in corporate issuance.

The automotive and utilities sectors showed particularly strong issuance, with key contributors including Volkswagen, Snam, EnBW, and Iberdrola. Several established names, such as Japan Housing, Korea Railroad, China Three Gorges, Société Générale, and Equinix also came to the market last month. Additionally, Goodman European Partnership, a logistic real estate company successfully launched its inaugural green bond.

The demand for impact securities remains robust, as reflected in the high bid-to-cover ratios that surpass those of non-impact securities. A noteworthy example was Smurfit Westrock's dual-currency green bond, which garnered substantial interest, enabling the issuer to upsize the deal and secure tighter pricing.

Credit markets experienced resilient performance against a backdrop of rampant rate volatility, on continued strong US data and a surprise increase in euro area inflation. Investor focus shifted to the election and the FOMC's decision to again lower the target range for interest rates. Meanwhile, initial jobless claims fell to their lowest level in seven months in a further indication of a robust US labour market — leaving market participants pricing in higher odds that the Federal Reserve will keep rates unchanged in December.

European credit emerged largely unscathed from what is undoubtedly the most consequential weeks in years in terms of global politics, trading relations — and ultimately the trajectory of rates and inflation. In

addition to heightened violence in the war between Russia and Ukraine, political instability in France returned as a macro-headwind for European investors after a deadlock over the new budget.

Elsewhere in Japan, uncertainty remains elevated and the BoJ continues to signal at a readiness to move in December.

PORTFOLIO POSITIONING

The fund underperformed the benchmark over the month (-1.69% vs. -1.37%), bringing the since inception return of the portfolio to 0.61% vs 0.54% for the benchmark. This was mainly due to security selection in US dollar bonds and the underweight weighted duration position in Chinese renminbi bonds. This decline was partially mitigated by the underweight position in euros and effective security selection in that currency. Furthermore, the fund's overweight duration position in euro and sterling-denominated bonds contributed positively to overall performance, although this was offset by security selection in Chinese renminbi-denominated bonds.

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. During the month, we took the opportunity to halve the size of our position in this market, given the increasingly uncertain economic outlook. The fund is also slightly underweight the US believing that the US economy is likely to remain more resilient than market expectations and as such result in higher yields. However, during the month we also reduced our US dollar underweight duration position and increased our weighting in US dollar bonds due to some temporary outperformance vs the European bond market.

Within Europe, we hold small overweight positions in the Norwegian krone, Swedish krona, and UK Sterling denominated bond markets. We

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slightly increased our weighting in UK sterling denominated bonds slightly relative to euro bonds due to some weakness in UK yields after the budget announcements. 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.

We have continued to add to our MBS positions in Fannie Mae and Freddie Mac green bonds, and now have approximately 6.25% exposure to this sector. We purchased our first Municipal social bond issued by New York City, achieving a yield pickup relative to other similarly rated paper.

We have added a few sub-investment grade and lower rated investment grade securities from issuers such as Rumo, Ellevio, and National Grid. We took the opportunity to purchase new green bonds on the primary

market from the Export-Import Bank of Korea, Ellevio and Goodman European Partnership. The latter is a European logistics real estate company, and the proceeds of this security are going towards renewable energy and investments in solar PV development.

CONTRIBUTORS

- Underweight position in euro
- Overweight weighted duration position in euro and sterling denominated bonds
- Security selection in euro denominated bonds

DETRACTORS

- Security selection in US dollar denominated bonds
- Underweight weighted duration position in Chinese renminbi denominated bonds
- Security selection in Chinese renminbi denominated bonds

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