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MARKET REVIEW

Additional signs of economic weakness in the US prompted a greater-than-expected Fed rate cut. In Europe, monetary policy easing continued as the euro area economy remained at a standstill while inflation pressures abated. Most fixed income sectors produced positive total returns and outperformed duration-equivalent government bonds.

US economic data releases lagged, highlighted by a fragile labor market amid weaker non-farm payroll report in August and elevated continuing claims. According to the Conference Board Index, consumer confidence sank to a three-year low driven by a negative assessment of business conditions and the labor market. Year-over-year headline CPI growth during August moderated to its lowest level since February 2021. S&P global manufacturing PMI continued to recede, while services and composite PMIs were little changed. Retail sales posted modest gains, wholesale inventories rose, durable goods orders were flat, and industrial production improved slightly, related in part to the recovery of motor vehicles and parts. In housing data, the interest rate decrease bolstered refinancing activity and housing starts. Eurozone manufacturing activity moved deeper into contraction. Germany's industrial production declined on a slowdown in the automotive sector, and the IFO business climate index fell for a fourth straight month. UK's S&P global manufacturing PMI dipped below estimates but stayed in expansionary territory, while year-over-year CPI remained steady on account of sticky energy prices. China's year-over-year industrial profits fell on adverse impact of extreme weather. Year-over-year inflation missed estimates as transportation and home goods costs declined. Japan's year-over-year services producer prices tempered. Canada's unemployment rate ticked higher, while annual inflation eased. In Australia, concerns over economic outlook and the job market dampened consumer sentiment.

Major central banks' paths to policy normalization continued to diverge across countries and regions as domestic economic cycles increasingly dictated policy decisions. The US Fed joined other central banks in cutting policy rates, delivering a larger-than-anticipated 50 basis points cut. The ECB lowered rates for the second time this year as inflation continued to slow and the eurozone economy struggled to gain momentum. The Riksbank delivered another 25 basis points rate cut as inflation pressure declined over the year. All other major central banks kept rates on hold.

FUND PERFORMANCE AND ATTRIBUTION

Interest rate strategies detracted. In country relative value strategies, our long Germany 10yr versus Italy detracted from performance as spreads tightened. Italian bonds outperformed German bonds as the market's confidence in Italy sustaining a relatively high nominal growth in a disinflationary environment came down. In contrast, our steepening position in the US contributed from performance over the month. Sovereign bond yields continued to move lower, with yield curve steepening in major developed economies over the course of September. US Treasury yields, led by the front end, declined notably as the Fed delivered larger-than-expected rate cut of 50 bps, and signaling for more easing ahead.

Currency strategies were positive. Our short USD bias against a basket of G10 currencies (primarily NZD, GBP, and AUD) contributed favorably to performance as the dollar experienced a broad-based weakening against most developed market currencies in September. Partially offset the positive performance was our short SEK as the SEK appreciated slightly versus the USD over the month.

Credit strategies were muted. Our overweight to EM debt allocation were additive. Spread narrowing contributed favorably to external debt performance, while a decrease in US Treasury yields also had a positive impact. Our overweight to high-quality SSAs detracted, offsetting the positive effect from EM debt allocation.

FUND POSITIONING AND OUTLOOK

We favor a curve steepening bias in US duration, and eurozone duration. We continue to believe that markets will engage with cyclical headwinds in the near term as economic data softens in the near term. Over the medium term, it is unclear whether inflation can be sustainably reduced back towards the Fed's 2% target.

We are overweight duration in smaller, open economies (Australia, New Zealand, Norway). They have significantly higher level of household debt than their DM counterparts and as a result display higher interest rate sensitivity.

We are underweight Japanese duration with a curve flattener. We believe current policy rates are still too low given the reflation forces at play in the Japanese economy, and the probability is skewed to a faster normalization of rates from Japan, and the policy rate should be nearer 1% over the next 12 months.

We are underweight UK. UK inflation is proving sticky with an improving economic growth outlook through renewed housing activity, strong consumer spending and resilient household balance sheets. We expect the BoE to engage in a more measure cutting cycle than what markets are pricing in.

We continue to hold a short USD bias versus G10 FX is primarily expressed via overweight exposures to AUD, GBP and JPY. We think a gradually slowing US economy and Fed dovish stance on rate-cut will weaken the US dollar from its current elevated level against other G10 FX.

We are underweight low-yielding APAC EM FX (CNH) while maintaining long exposures to an overall diversified basket of EM FX. We remain bearish on low-yielding APAC EM currencies, particularly CNH, against a backdrop of weak growth and low inflation, though we are mindful of policymakers' pro-growth stance and the impact of Fed easing.

PAST PERFORMANCE DOES NOT PREDICT FUTURE RETURNS. AN INVESTMENT CAN LOSE VALUE.

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