Wellington Opportunistic Fixed Income Fund

WELLINGTON MANAGEMENT®

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MARKET REVIEW

- Broadly encouraging economic data releases contributed to rising sovereign yields against the backdrop of political uncertainty stemming from the US elections and intensifying tension in the Middle East. Most fixed income sectors outperformed duration-equivalent government bonds.
- US economic data releases were mixed, strained in part by the impact of two major hurricanes. The unemployment rate held steady and weekly jobless claims were range bound, while nonfarm payrolls fell short of expectations. Retail sales gained across most categories; however, consumers remained frustrated by persistently high prices. The NFIB small business optimism index missed expectations, while consumer confidence improved according to the Conference Board Index on a positive assessment of the labor market. Industrial production stalled amid the workers' strike at Boeing and hurricane impacts. The ISM manufacturing index continued in contraction territory as production and demand cooled, while cost of inputs remained a hinderance. Most regional manufacturing surveys also posted weak results. In housing data, a pickup in borrowing costs and rising sales prices weighed on existing home sales, while new home sales gained.
- Eurozone annual inflation edged higher, while constrained new orders and backlogs weighed on manufacturing PMI. Germany's IFO business climate index rose, with assessment of current conditions and expectations both improving. UK's S&P global manufacturing PMI dipped slightly but stayed in expansionary territory as an improvement in new orders was offset by the increased cost of raw materials.

FUND PERFORMANCE AND ATTRIBUTION

- The portfolio generated negative total returns during the month of October.
- Over the month of October, negative total returns were driven by our strategic sector positions followed by tactical and relative value positions.
- Within our Strategic sector, negative performance was driven by our Emerging Markets Opportunities and Activist Government theme. Within emerging markets, local markets debt underperformed external debt. Spread narrowing contributed favorably to external debt performance, while an increase in US Treasury yields had a negative impact. EM currencies depreciation and higher rates drove the negative performance within local markets.
- Within Relative value, exposure to Discretionary Macro Rates and Opportunistic Currencies had a negative impact on performance. The USD appreciated against major developed-market and EM currencies, helped by tempered expectations for Fed rate cuts and betting markets increasingly pointing to a second Trump term. Among the G10 FX, the NZD was weighed down by a strong US dollar, disappointing domestic economic data, bigger rate-cut bets by the RBNZ, and the lingering concerns around China. The JPY hit a three-month low against the USD, as an election loss by Japan's ruling coalition raised political and monetary policy uncertainty. Within EM FX, performance was broadly negative, with the possibility of Trump's re-election and fewer US rate cuts. LATAM currencies led the underperformance. The BRL plunged to a near three-month low as the country's current account deficit widened in September. The MXN hit a two-year low against the USD, with investors focused on developments around the judicial reforms.
- Tactical strategies detracted over the period. Negative performance was driven by our exposure to Duration Management and Agency mortgages. Agency MBS underperformed duration-equivalent Treasuries. Rates moved sharply higher amid favorable economic data and as market participants considered potential US presidential election outcomes. Within the sector, conventional mortgages underperformed GNMA mortgages.

FUND POSITIONING AND OUTLOOK

- 2024 thus far has presented a favorable environment for US assets (equities and credit) as market pricing has now fully engaged with a soft landing. We are regularly asked "when will the business cycle turn and send the US into recession?" Implicit in this query is the idea that economic cycles should dictate asset-price returns. But this is rarely the case. The slowdown caused by the COVID-19 pandemic, for example, was the worst economic recession since the Great Depression yet its impact on asset prices was short-lived, thanks to the unprecedented fiscal and monetary response in the US and around the world. More recently, US housing starts — a key leading economic indicator — have been anemic, yet most homebuilder stocks have outperformed owing to a structural lack of inventory. These dynamics suggest that the relationship between asset prices and the economic cycle is tangential at best, and that individual industries and market segments can experience ups and downs independent of broader macroeconomic trends.
- The US Federal Reserve's (Fed's) recent interest-rate cut (and Chair Powell's subsequent commentary) could have a meaningful impact on the relative cycles of a number of industries, so it is first important to decipher what this last meeting could mean for future policy. The market seems enamored with the question of whether the Fed will cut 25bps or 50bps next meeting. The more salient point is that the Fed no longer believes the labor market to be a significant source of inflation, and is therefore shifting to its pre-pandemic policy of aligning the fed funds rate with its view of the neutral rate of the economy — currently around 3%. This theory was all but confirmed in the Fed's September "dot plot," with the median FOMC participant indicating that future cuts would achieve the central bank's estimate of neutral by the end of 2025. Unless inflation surprises meaningfully to the upside, the state of the US labor market should continue to be the best clue of how close the Fed believes rates are neutral.
- We continue to source our duration risk globally either through global inflation-linked bonds, Emerging Market Local Bonds or our Core Challenges, where we are trying to find government bonds in countries with much more sustainable fiscal trajectories, and who will be less sensitive to the political outcome in the next few weeks. We expect continued cyclical volatility from a slowing US economy and electoral uncertainty, but perhaps more resilient global economy and believe our Relative Value allocations have the capabilities to monetize this volatility much like they did in the third quarter.

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

Fund performance is based on USD S Acc share class and are net of fees and expenses. Other share class performance may differ.| Index used in the calculation of attribution data: Non-benchmark Relative Strategy.| Fund performance is net of actual (but not necessarily maximum) withholding and capital gains tax but are not otherwise adjusted for the effects of taxation and assume reinvestment of dividends and capital gains.| If an investor's own currency is different from the currency in which the fund is denominated, the investment return may increase or decrease as a result of currency fluctuations.| The views expressed are in the context of the investment objective of the Fund only and should not be considered a recommendation or advice.

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