New Capital Sustainable World High Yield Bond Fund

Quarterly Commentary | As of 30 September 2024

Market overview

The third quarter of 2024 experienced a sustained rally in global equity markets, despite occasional volatility and economic uncertainties. The MSCI World Index and the MSCI All Countries Index showed consistent gains, with year-to-date returns of 19.1% by the end of September.

The quarter opened with a change in investor sentiment in July. Soft US Consumer Prices Index (CPI) inflation numbers led to the anticipation of a Federal Reserve funds rate cut, prompting a move from mega-cap tech stocks to US small-cap stocks. Reflecting a weakening in the US economy, bond markets rallied, with yields on US Treasury bonds falling to the lowest in more than a year.

August witnessed a continuation of the equity rally, but volatility increased due to fears of a looming US recession and changes in Japanese monetary policy. These concerns added to geopolitical tensions and the prospect of monetary easing and contributed to extend the gold price rally.

September brought new all-time highs for global stock markets. The Federal Reserve started easing interest rates, shifting its focus from inflation control to supporting the labour market and economic growth. Chinese authorities announced measures to stimulate their economy, and declining oil prices provided further market support. Throughout the quarter, all major developed market currencies and the yuan renminbi recovered against the US dollar.

The outlook at the of the quarter is supported by the expectation of a prolonged period of monetary policy easing and moderate bond yields.

Fund performance and positioning

The Fund underperformed its index in Q3 2024 (see performance table). This was driven by ratings bucket allocation and yield curve positioning. Ratings bucket allocation led to underperformance as the portfolio is structurally weighted to be higher in quality, with an overweight to BBs and an underweight to CCCs. This cost the portfolio -37bps in Q3. Over the long run, we expect the relative performance impact from ratings bucket allocation will be net to zero, as the long-term excess return of BBs tends to be comparable to the broader high yield market. Yield curve positioning slightly detracted from performance in Q3, costing the portfolio -11bps, due to a slight underweight to USD rates risk.

Security selection led to outperformance, contributing +4bps. Over the long run, this is where we seek to drive alpha. The outperformance was driven by names such as Asos, Ziggo, Iceland, Intrum and ING bank. Several new positions were added to the portfolio in Q3. This included, Zegona, the Spanish spin-off of Vodafone; Global Atlantic, a US insurance business; Columbia, a socially linked Columbian government bond; Sani-Ikos, a European luxury all-inclusive resort; EDF, the French nuclear power company; and American Airlines, a leading US airline.

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	New Capital Sustainable World High Yield Bond Fund	BofA Merrill Lynch Global High Yield Constrained index	Difference
1 Month	+1.26%	+1.58%	-0.32%
3 Months	+4.37%	+5.00%	-0.63%
6 Months	+5.83%	+6.52%	-0.69%
YTD	+7.62%	+8.68%	-1.06%
1 Year	+15.68%	+15.94%	-0.26%
Since Inception Annualised	+1.04%	+3.01%	-1.97%
Since Inception (27/10/2021)	+3.08%	+9.08%	-6.00%

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Outlook

Based on the ICE BofA global high yield index, high yield spreads vs government bonds ended the quarter at 345bps. This is below the long-term average since the end of 2003 of around 530bps, implying that spreads are on the rich side and defaults are expected to remain low. This is in line with Moody's 1yr issuer default rate forecast of 2.76%, which is below the long run median of 3.10%. Of note, this default rate is based on the issuer count, not dollar-weighted. The expectation is that the dollar weighted default rate will be lower as the companies currently struggling to tend to be smaller, which when they default in number inflate the issuer count default rate number.

In a scenario where spreads stay rangebound/move edgeways, i.e., the soft-landing scenario, the 1yr return from a high yield will roughly equal the yield, less losses given defaults. The yield to worst is currently at 6.8%, which, when deducting deducted losses given defaults, would give a 1yr return in the 5.8% area (based on a long run dollar weighted default rate of 2% and a recovery rate of 50%). This compares to a yield of 3.5% for US 5-year government bonds.

In a downside scenario, spreads tend to only widen materially during a crisis, such as covid and the 2015 commodity crisis, generally maxing out in the 700bps area. If spreads do widen to 700bps, this would lead to a downside price move due to spreads of -11% (around 350bps of spread move x 3.1 years of effective duration). However, the spread widening would be offset by the ongoing high carry of the asset class and any move in rates. We expect the carry will be in the 5.8% area (as shown above). In addition, in such a crisis, we could expect rates to move down at least 1%, which would provide an upside in price of around 3.1%. Thus, the combined impact of carry and rates of around 9% would for the most part offset your downside move from spread widening.

From a risk/reward perspective, it is probable that over a 12-month horizon the upside from the high yield will be equal to the carry of 5.8%, and the downside will be in the region of -2%.

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All sources: EFG Asset Management (UK) Limited ("EFGAM"), Factset, Bloomberg, Morningstar as at end of the month. Any other sources as applicable.

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agree that we may cease providing financial services to you if you are no longer a wholesale client or do not provide us with information or evidence satisfactory to us to confirm your status as a wholesale client;
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