APRIL 2022
MONTHLY UPDATE

Evolve Active Global Fixed Income Fund

EARN seeks to generate positive returns throughout the interest rate and economic cycles, firstly by allocating to different credit asset classes, and also through bottom-up individual security selection.

TSX EARN

ETF TICKER: EARN
MUTUAL FUND FUNDSERV CODES: EVF130 (CLASS F); EVF131 (CLASS A)
SUB-ADVISOR: ALLIANZ GLOBAL INVESTORS (ALLIANZGI)

Allianz

AllianzGI is one of the world's leading active investment managers, managing over USD 703 billion in assets, including over USD 239 billion in global fixed income (as at December 31, 2021).

In April, interest rates rose further as hawkish rhetoric from the US Federal Reserve and other central banks intensified. Inflationary pressures remain front-and-centre of central banks' minds, especially at the Fed; 10-year US Treasury yields ended the month 54bps higher at 2.88%. The ongoing crisis in Ukraine continued to exacerbate concerns about European energy security, pushing growth and inflation expectations in opposite directions and leaving the European Central Bank in a difficult position ahead of its June policy meeting. 10-year German bund yields climbed to 92bps, their highest levels since 2015. There were no changes to ECB policy in April, but there was a strong focus on the risks of the Russia/Ukraine conflict and its implications for economic growth in the region. A diverging monetary policy stance between the Fed and other major central banks saw the trade weighted US dollar climb to around 20-year highs. Oil prices fluctuated during the month but ended slightly higher at $105/barrel, from $100.

In the credit markets, investors worried about Covid-related lockdowns in China, Russia cutting off gas supply to Europe, and the potential for both to exacerbate supply chain issues and hence inflation worldwide. Spreads on the investment grade corporate universe widened out 18bps for the period; high yield was +39bps. Lower rated issues did slightly better in total return terms, given their shorter duration profile. By region, Emerging Markets bucked recent trends and performed relatively well; Europe had the advantage over the US in total return terms given less severe interest rate rises.

In this context the portfolio was negative for the month; for context, Global Investment Grade Corporates were down over 4% and high yield was -3.2% for the period. Losses were evenly spread across the portfolio given the market moves; there were no idiosyncratic issues on any name. Our securitized allocation was relatively resilient, and our hedging positions were beneficial.

During the month we had several bonds redeemed by the issuers in personal care, food, and real estate. We also reduced one name in building materials. We recycled the proceeds into financials, media, REITs, and telecoms.

Outlook

Russia's invasion of Ukraine and downside growth risks in China and Europe further underscore our concerns about the macroeconomic outlook through the remainder of 2022, with stagflation risks in this cycle continuing to grow.

On the other hand, corporate earnings have mostly come in ahead of expectations for the first quarter and balance sheets remain relatively strong compared to historic averages.

We expect default rates to rise slightly over the next year, albeit from what were historic lows. With current levels of market volatility, high yield spreads look somewhat tight, however a return to more "normal" conditions would suggest some opportunity, particularly in lower-rated credits.

While the Year-to-Date moves in rates and spreads have been painful, investment grade spreads are back to longer term averages at 143bps, while the global high yield index now offers a spread of 451bps and a yield of over 7% in local currency terms, meaning that the likelihood of positive excess returns vs. cash and government bonds going forward are higher.

Evolve ETFs
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