TSX EARN

MONTHLY COMMENTARY

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.

For the month ending November 29, 2019

ETF TICKER: EARN (Hedged)
MUTUAL FUND FUNDSERV CODE: EVF130 (Class F); EVF131 (Class A)

Allianz Global Investors

SUB-ADVISOR: Allianz Global Investors (AllianzGI)

AllianzGI is one of the world's leading active investment managers, managing USD 601 billion in assets, including over USD 200 billion in global fixed income (as at March 31, 2019).

MARKET UPDATE:

November was another positive month for the credit markets overall in spite of rising government rates, particularly at longer maturities. Returns on Investment Grade (+62bps in USD hedged terms) and BB/B high yield (+61bps) were both positive with spreads tightening 1bp, while CCCs continued to struggle with spreads widening 42bps for a total loss of -149bps. Year to date, investment grade and higher rated high yield have delivered over 12% and 13% respectively, while CCCs have only managed 6.7% despite the favorable environment for risk assets which underlines our long repeated mantra that yield does not equal return. By region, US investment grade and European high yield performed best. Oil prices climbed for most of the month before correcting sharply at the end.

PORTFOLIO UPDATE:

Spread tightening in the BBB-BB holdings, combined with the portfolio carry, offset the adverse effects from rising government rates. Financials performed well as yield curves steepened, while high yield was also additive, with our minimal exposure to CCCs beneficial. Our equity futures hedge position was detrimental as stock markets continued to rally.

During the month we added some new names in healthcare and exited a couple of names in banking. We added some diversified financials exposure out of securitized and investment grade industrials.

OUTLOOK:

In Investment Grade credit, total returns this year have been at the upper end of our expectations. From here, we see spreads likely supported into year-end as supply wanes. However, tight valuations drive our view for potentially incrementally wider spreads next year. With weaker liquidity in the European market and increasing conviction in higher bund yields we favor reducing some exposure in European credit, but overall our positioning is driven by sectors with good capital levels (US Financials) and committed backlogs from government fiscal spend (Capital Goods). We are very selective in cyclical sectors (Retail, Consumer Goods).

In high yield, our expectation is that defaults will rise slightly in the coming year, however this should be predominantly confined to CCC issues, in which the portfolio invests only very selectively. For BB/B issues, our default forecast is c.1% and this is still relatively low vs. historical averages, while effectively already compensated for by current spreads. High yield fundamentals are positive, with corporate earnings generally up in the 3rd quarter and interest coverage improving thanks also to cheaper debt. Global growth looks to be sub-trend for 2020, though it should still be adequate for the higher rated issuers as those found in the portfolio. The deteriorating fundamentals and rising downgrades in the leveraged loan market may however become a negative influence in the high yield bond space, so we are watching the situation closely.