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.

As at April 30, 2020

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

SUB-ADVISOR: Allianz Global Investors (AllianzGI)

Allianz Global Investors

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 & PORTFOLIO UPDATE:

Even as economic data showed severe contractions globally, financial markets struck a positive tone in April. Equity markets were up over 10%, while in the credit markets spreads retraced some of the losses experienced in February and March. Investment grade was 80bps tighter, and high yield overall was 139bps tighter. Within high yield, single Bs were the sweet spot in credit terms, tightening 212bps, while BBs were 109bps tighter (their longer duration made them outperformers in total return terms) and CCCs lagged with only 40bps of compression. Government yields were moderately lower in core markets but southern Europe struggled. In the oil markets, we witnessed a truly extraordinary event as WTI crude futures achieved a negative price of -$37 per barrel on oversupply and lack of storage capability; they finished the month at just under $19 per barrel, still a low for this century.

As such, 1-5yr investment grade corporates were up 2.4% in CAD hedged terms, BB/B high yield was up 4.7%, while CCCs were only up 1.3%. Despite the convulsions in the crude futures market, energy related high yield was nearly 700bps tighter and up 15.5% in total return but still remains down over 31% year to date.

The Fund rebounded strongly during the month, with returns driven by spread tightening, particularly in our financials and high yield industrial allocations. Emerging markets also made a significant positive contribution, particularly from Latin America, while returns from securitised were more modest. Midstream energy, which is focussed on pipelines and storage, featured heavily in our top performers, as did some of the long dated insurance paper. We reduced our equity hedge position to 3% but this still detracted as the S&P rose over 12%.

During the month we made quite a few changes, adding several new names opportunistically in energy, communications, technology and transportation, while using the bounce to exit some of our holdings in southern European financials and drawing down some of the cash balance which is currently around 5%. We exited one consumer name which had hit our stop-loss level and whose management were not sufficiently willing to engage or provide transparency.

OUTLOOK:

It increasingly looks as though the pandemic and the surrounding public health measures will have longer lasting effects on economic growth than had been previously anticipated. The credit ratings agencies have also been swift and uncompromising in downgrading companies, with over $100bn of debt falling from investment grade into high yield.

In this scenario, credit looks well-placed as it should be resilient enough to withstand the downturn (away from CCCs and industries subject to further shutdowns). Many “fallen angels” represent buying opportunities as spreads trade wide and there is much room for credit improvement as cash is preserved and dividends and share buybacks are deferred. Central banks and governments have also committed to substantial support measures for the economy and financial markets, even including purchases of non-investment grade debt.

While BBs in particular look to be attractive relative now to our expectations of defaults and downgrades, there are of course downside risks if the epidemic and economic figures deteriorate further. Careful attention is also needed to identify strengths and weaknesses at the individual issuer level.