AUGUST 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.

TSX EARN

EARN (Hedged)

MUTUAL FUND FUNDSERV CODE: EVF130 (Class F); EVF131 (Class A)

SUB-ADVISOR: ALLIANZ GLOBAL INVESTORS (ALLIANZGI)

AllianzGI is one of the world's leading active investment managers, managing USD 692 billion in assets, including over USD 242 billion in global fixed income (as at December 31, 2020).

PERFORMANCE ANALYSIS:

August was a mixed month for credit as the carry of the asset class and some spread tightening for higher-rated high yield met negative impacts from rising longer term government rates. Risk sentiment improved into month-end following comments by US Federal Reserve Chair Powell which emphasized a reduction in asset purchases over interest rate hikes, which were received as dovish by the market. Investment Grade Corporate spreads were unchanged at 93bps, while the BB/B universe was 24bps tighter, reversing the widening seen in July. CCCs widened 60bps but were still up overall thanks to their carry and short duration profile. By region, Asia performed strongly as a bailout for a major financial services company in China soothed nerves, although concerns intensified over another large issuer there in real estate. After a strong run, oil prices slipped back below $70/barrel on expectations of increased production by OPEC+ members, but the sector still managed to tighten 18bps and deliver positive returns.

In this context the portfolio was down marginally; our financials and Asian holdings performed well. There were few detractors on an individual level, with none costing more than 1bp.
During the month we had bonds redeemed in restaurants and retail. We exited other positions in capital goods and basic industry. We added new names in financials, hospitality, transport, and consumer services.

Macroeconomic data has been mixed with US GDP in line with expectations and Covid infection rates persistently high. Business confidence in Europe looks weak and the German elections may see a change in the political outlook there. On the other hand, the US Fed Chairman's comments suggest a relaxed view of current high inflation levels and a more dovish approach to policy normalization than in previous cycles.
In the corporate world, nearly all S&P 500 companies have now reported for Q2, with an average earnings surprise of +16%. Balance sheets also look solid with historically high levels of cash.
Near-term, we remain constructive on credit given we believe that a modest deceleration in growth shouldn't be sufficient to derail the continued improvement in corporate fundamentals, which in turn should support spreads. High yield looks fairly priced in line with our declining expectations for defaults.
We expect September to be very busy in the new issue pipeline; our current risk positioning gives us scope to be proactive in the primary markets over the coming weeks.

We see an environment where rates look reasonably well-anchored, the overall compression in spreads looks to be running out of steam and the bid for credit from beyond the traditional buyer base looks entrenched. Individual credit improvement stories like selected banks in Ireland and a Nordic retailer are steadily playing out, and we continue to seek out new ideas.
We have recently reviewed our expectations for defaults in high yield and revised them lower given prolonged central bank support, positive earnings trends, and limited refinancing hurdles. As such, we believe credit continues to offer a reasonable premium over cash and government bonds.

Evolve ETFs
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