OCTOBER 2021 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**

MUTUAL FUND FUNDSERV CODES: 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).

In September, a raft of more hawkish central bank policy statements against the backdrop of heightened inflation concerns pushed global sovereign bond yields sharply higher. 10-year US Treasury yields ended the month 18bps higher at 1.49%, with other developed bond markets following the US lead. In currency markets, the US dollar was the main beneficiary, on a trade weighted basis, rising to one-year highs. Oil markets rallied with WTI crude hitting $75/barrel, a level last seen in October 2018. Other commodities generally followed suit. This all resulted in investors worrying both about stagflation and inflation.

In the credit markets, spreads were mixed on the prospect of tighter monetary policy as well as concerns over risks in China. Apart from new regulations on various sectors such as technology, gaming, and education, we also saw one of the largest Chinese real estate firms effectively defaulting. Investment Grade corporate spreads were 3bps narrower; the Global High Yield universe was 7bps wider overall, but this was driven by emerging market names as developed country names were flat to slightly tighter.

In this context, the portfolio was up slightly as interest rate effects were outweighed by positive credit contributions; our banking names were also notably beneficial. The performance was ahead of traditional credit indices thanks to the short duration of the portfolio; the equity index hedge was also helpful as stock markets weakened.

Portfolio strategy and activity

During the month we added some new names in banking, capital goods, and telecoms. We exited positions in healthcare, non-bank financials, and energy.

Cyclical growth in the US remains strong while Chinese growth seems to be decelerating. Europe offers potential upside as vaccine take-up progresses. Companies have taken the opportunity to term out existing debt at low levels; supply is therefore expected to decline while investor demand for yield remains strong. Therefore, we still expect a favourable backdrop for risk sentiment and market dynamics over the coming months.

Investment grade spreads are screening rich while high yield spreads look fairly valued overall, albeit with the favourable technical and pockets of value. With most high yield companies having been able to term out their debt and an earnings recovery, our estimated default rate for the next 12 months, while ticking up slightly, should remain low at around 1%. Emerging Market spreads appear cheap to default expectations while US and Europe look rich, however this is mostly from Asia and recent news flow has reminded us that spreads can remain wide for long periods.

OPEC discipline combined with accommodative monetary policy should support oil and other commodity prices although the impact of China may hit Iron and Copper. Developed economies are tentatively opening up again, which should then favour more cyclical and Covid-hit areas.

Shortages in semiconductors, supply-chain disruptions, higher gas prices and labour inflation will show through in certain businesses that cannot pass on higher costs.

Evolve ETFs
Scotia Plaza, 40 King Street West, Suite 3404, Toronto ON M5H3Y2
416.214.4884 | 1.844.370.4884 | www.evolveetfs.com