NOVEMBER 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**

ETF TICKER: 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 November, COVID once again dominated the headlines as rising infection rates in Europe and the emergence of a new Omicron variant - which appeared to be more transmissible than the Delta variant - resulted in a sharp deterioration in risk sentiment. The sell-off in front-end rates that had occurred in October was partially reversed as rate hike expectations across the G10 markets were pared back, although Fed Chair Powell did signal the possibility of an earlier end to asset purchase tapering given heightened inflation risks. Crude oil prices also reversed their recent gains, falling to three-month lows. Ten-year US Treasury yields closed the month 11bp lower at 1.45%, with equivalent Bund yields 24bp lower at -0.35%. Against this backdrop, the US dollar was the main beneficiary, seeing broad-based gains, and rising on a trade weighted basis to its highest levels since mid-2020.

In the credit markets, spreads were range-bound for the first 3 weeks of the month before gapping wider in the last week. The media blitz regarding the new variant happened on the evening of the US Thanksgiving holiday – one of the lowest points of market liquidity for the whole year – prompting a selloff in various assets sensitive to global growth such as oil. This was followed by Moderna saying that they did not think their vaccine will be as effective against Omicron, and although Pfizer and Oxford/AstraZeneca offered more optimistic views subsequently, the damage was already done. While we still need more data, our first impression is that this new strain will not derail the overall recovery but may cause a slight delay. Investment Grade Corporate spreads were 14bps wider but eked out a small positive total return on falling interest rates; high yield spreads were 50bps wider for a negative total return. By region, Europe outperformed the US, and Emerging Markets continued to struggle driven by the ongoing situation with Chinese real estate. Energy was one of the sector laggards given the fall in oil prices.

In this context the portfolio was down given the general market sell-off. There were no outsize losses on a security level; by industry, energy and airlines predictably detracted. The equity hedge position was beneficial and our healthcare, pharmaceutical and securitized holdings were relatively resilient.

Portfolio strategy and activity

During the month we added in banking, food production and a film studio new issue. We reduced in autos, securitized, retail, and pharmaceuticals.

Global growth momentum looks to be reverting back to trend heading into 2022, with the US continuing to outperform while Europe is around expectations, and China faces challenges.

There are persistent signs of supply chain pressures as the world "gets back to normal," and energy cost inflation, factors which we do not expect to de-rail the overall trend but may drive greater dispersion between sectors and credits. In addition, as the strong fiscal impulse of the last eighteen months diminishes and real incomes are squeezed, we would expect aggregate demand in economies to moderate.

Expectations for a significant spike in default rates in the wake of the pandemic have not materialized other than in the troubled Asian real estate sector, and our overall outlook for defaults remains benign.

Notwithstanding the reversal in recent days, interest rates are generally on an upward path as central banks prepare an orderly exit from crisis measures and respond to evidence of inflation. Rising yields and steeper intermediate yield curves are consistent with the global recovery, and underscore the attractiveness of shorter duration, higher spread credit.

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