JULY 2022

MONTHLY UPDATE

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 over USD 703 billion in assets, including over USD 239 billion in global fixed income (as at December 31, 2021).

July saw government bond yields reverse course as fears about the tightening of financial conditions and squeeze in households' real incomes raised fears of a sharp economic slowdown in H2 2022 and into 2023. In the US, the Federal Reserve hiked rates by a further 75bps to a target range of 2.25-2.50%, with the Fed signalling a more data dependent approach for future rate hikes; 10-year Treasury yields ended the month at 2.65% (around 83bps lower from the June peaks). The bond market rally was especially evident in core Euro area bond markets as recession fears began to grip the region, just as the European Central Bank hiked policy rates by a larger than expected 50bps, bringing an end to negative interest rate policy in the region. 10-year Bund yields ended the month back at 82bps.

Despite the deteriorating growth outlook, which was confirmed by the news of a second consecutive quarterly contraction in the US, credit markets were buoyed by the prospect of some relief in monetary tightening, as well as the fact that valuations had become fairly attractive. Investment Grade spreads were 13bps tighter, with European issues outperforming, particularly in subordinated financials. Global High Yield spreads tightened by 83bps for the month, with the US a clear outperformer, followed by Euro, with Sterling and Emerging Markets issues posting some more modest gains. Once again, Asia was the underperformer, being one of the few market segments to post a negative return. By rating, Bs were strongest in spread terms but marginally behind BBs in total return given their shorter duration. CCCs lagged on the lower growth dynamics. Oil futures retraced just below $100/barrel, but energy names still performed respectably as this represents a profitable level for most companies in the sector.

In this context the portfolio was up strongly for the month. Returns were ahead of the 1-5y investment universe thanks to some strong contributions in our financials allocation – in particular one of our REIT names recovered from an oversold level the previous month, vindicating our conviction.

During the month we added in commercial services, REITs, pharmaceuticals, and energy. We did an issuer switch within banks. We had a bond redeemed within securitised and reduced in real estate.

Going forward, the tight global monetary policy stance is increasing downside growth (and recession risks) for the global economy over the next 6-12 months, although heightened near term inflationary pressures would suggest that central banks will still be slow to pivot from their hawkish policy stance relative to recent economic cycles. We believe that, at least in the short-term, central banks will want to deliver on current market pricing for rate hikes into year-end, although we think that the appetite for further tightening is likely to wane into 2023 as downside growth risks become more evident. Over the short term, although risk assets will likely continue to anticipate a Fed pivot towards a less restrictive monetary policy stance, a Fed fixated on monthly CPI prints, while economic activity deteriorates, is likely to keep bond market volatility high.

Corporate earnings for Q2 have been a mixed bag; what is abundantly clear is that companies who disappoint are seeing their equities and bond prices severely punished, but weakness is not indiscriminate, and the market has been surprisingly pleased by results in sectors like airlines and hotels.

In terms of our overall positioning, we are generally comfortable at the moment. The 2-3yr part of the yield curve has been relatively stable; several months of re-investment at higher rates is helping performance and spreads have been on a tightening bias too. Strategically, there is not much we are anxious to do in the near term other than re-invest attractively and recent additions have been focused on short end investment grade bank bonds which look to offer value for low refinancing risk, good ratings, and a decent Q2 earnings season.

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