Quarterly Commentary

M&G Global Bond Fund

Global Income USD-denominated

Q3 2024

Market overview

The third quarter of 2024 (Q3) witnessed notable fluctuations in global financial markets, driven by diverse economic signals, a shift among major central banks toward easing monetary policies and geopolitical tension. In mid-September, the US Federal Reserve (Fed) implemented a sizable interest rate cut of 50 basis points, lowering the target range to 4.75%-5.00%. This shift propelled global equity markets to new heights, while weakening the US dollar to major currencies.

US Treasuries rallied leading up to the Fed's decision, while rate cuts pressured the U.S. dollar and led to a rally in US equities. This environment contributed to a rally in global bond markets, particularly reflected in the Bloomberg Global Aggregate Bond Index delivering 7.0% (US$) for the quarter.

United States

While the much-anticipated rate cut was no surprise, the Fed did, however, surprise markets by cutting rates by a sizable 50 basis points in September, marking the start of its first easing campaign in four years. This significant cut reflected signs of moderating inflation and a weakening labour market. The focus has shifted towards the quantum of future rate cuts before the market will get too worried about a possible US recession. Comments from Fed chair Powell also helped ease any market concerns as it suggested future rate cuts should be more muted depending on economic data and inflation reporting.

August's CPI came in at 2.5% y/y, aligned with expectations and down from 2.9% in July, while the core PCE price index, the Fed's preferred inflation measure, rose to 2.7%y/y. Q2 GDP exceeded expectations at 3% (q/q annualised), largely driven by consumer spending, while the downwardly revised Q1 GDP stood at 1.3%. The Fed maintained its growth forecast for 2024 at 2.1%.

United Kingdom

In the UK, the Bank of England (BOE) kept its main interest rate steady at 5 % during its September meeting, following a reduction from 5.25% to 5% in August. UK CPI held steady at 2.2% y/y in August, aligning with expectations as the BOE aims to return inflation to its 2% target.

UK GDP grew by 0.7% in Q2 2024, slightly below expectations, following 0.3%y/y growth in Q1, with underlying growth showing weakness in the first half of the year. In the UK National Election on 4 July, the Labour Party achieved a decisive victory, unseating the Conservatives after 14 years. Pre-election uncertainty caused some volatility, but the outcome was anticipated in the local financial markets.

Euro area

In the Euro area, the European Central Bank (ECB) lowered its main refinancing rate to 3.65% during its September meeting, as anticipated. August CPI was reported at 2.2% y/y, down from 2.6% in July and, aligning with the consensus, with the preliminary September number printing at 1.8%, below the ECB's 2.0% target.

Q2 2024 GDP growth surpassed expectations at 0.6% y/y but was revised down to 0.2% q/q, compared to 0.3% in Q1.

Japan

The Bank of Japan (BOJ) unexpectedly raised rates by 15 basis points from 0-0.1% to 0.25% on the last day of July, the highest level since 2008, and signaling a more hawkish stance than anticipated. This decision led to significant volatility in local equities and high-carry currencies.

Japan's August core CPI rose to 2.8% y/y, aligning with forecasts and accelerating for the fourth consecutive month. In a widely anticipated move, the BOJ maintained its benchmark interest rate at 0.25% at its September meeting, in its efforts to normalise monetary policy. The BOJ's decision came as it seeks to transition away from a long-standing ultra-easy monetary stance while safeguarding the economy. Japan's economy grew at an annualised rate of 2.9% in the second quarter, surpassing the projected 2.1%.

China

China's economy is showing signs of a modest recovery, but a slow start to the second half of the year is increasing pressure on the world's second-largest economy to implement additional stimulus policies. This came amid ongoing challenges, including a prolonged housing downturn, persistent deflation, rising debt issues, and escalating trade tensions.

The People's Bank of China (PBOC) announced broad policy easing measures to shore up a flailing economy. The central bank cut the rate on one-year medium-term lending facility (MLF) loans to some financial institutions to 2% from 2.3%. Additionally, the reserve requirement rate was reduced from 10% to 9.5%. Some questions around the Chinese economy remains, such as the health of their property market and the impact these changes will have on the recovery in that sector, but the market clearly thinks the initial actions were positive.

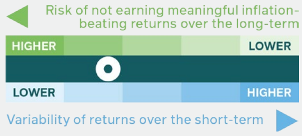
China's August CPI increased to 0.6% y/y from 0.5% in July but came in lower than the forecasted 0.7%. The uptick was mainly due to higher food costs from weather disruptions, rather than a recovery in domestic demand as producer price deflation worsened.

Performance

The Global Bond Fund returned 7.4% (in US$, net of fees), versus 7.0% from its benchmark, the Bloomberg Global Aggregate Bond Index. For the 12 months ending 30 September, the fund delivered 10.9% compared to the benchmark's 12.0% return (both in US$).

Annualised performance	B Class	Benchmark
1 year	10.9%	12.0%
2 years	6.8%	7.0%
3 years	-3.8%	-3.1%
5 years	-0.8%	-0.8%
7 years	-0.2%	0.3%

Risk profile



Fund facts

Fund objective
The Fund's objective is to generate investment returns through exposure to global bonds and interest-bearing instruments over the medium term.

Investor profile
Investors seeking returns from a diversified portfolio of global debt and fixed income securities. The recommended investment horizon is 2 years (or longer when used as strategic exposure to the asset class).

Investment mandate
The Fund aims to achieve its investment objective by investing in a diversified portfolio of global debt and fixed income securities. The Fund may invest in other collective investment schemes and in financial derivative instruments.

Investment manager
M&G Investment Management Limited (UK)

Fund managers
Eva Sun-Wai
Robert Burrows

Morningstar category
Global Flexible Bond

Benchmark
Bloomberg Global Aggregate Bond Index

Inception date
9 June 2017

Fund size
USD 191.5 million

Currency
US Dollar

Share type
Accumulation

Domicile
Ireland

Sources: M&G Investments, Morningstar & Deutsche Securities

The fund's absolute performance in the third quarter, was driven by the strong returns from global bonds, particularly long-dated US Treasuries. Eurozone sovereign bonds, UK gilts, emerging market sovereign bonds and corporate bonds also aided returns.

Strategy and positioning

During July, we reduced exposure to both short-dated German, and French, government bonds and moved into KFW (German supranational). After significant outperformance of New Zealand government bonds relative to their Australian counterparts, we switched exposure from the former into Australia, mostly via supranationals. It was a quiet month for credit trades, with the fund only slightly reducing exposure to one Italian bank, on valuation grounds. In emerging markets, exposure to the Dominican Republic was reduced due to valuations no longer appearing attractive. Finally, in FX we increased exposure to both the Mexican peso and New Zealand dollar and reduced the Japanese yen position in light of the very strong performance.

In August, we shortened the fund's duration, post the repricing of government bond yield curves early in the month, and especially in the US. We considered adding credit exposure through the primary market, however in recent new issues value is being squeezed and therefore opportunity to participate was limited. In emerging markets, we trimmed exposure to Indonesia following strong performance. In FX, a rally in the first week of the month, presented an opportunity to reduce our yen position. We also reduced some exposure to the Swedish krona.

Activity in September, we switched some exposure out of German bunds and into Australian government bonds and carried out a relative value trade on the US Treasury curve. In credit, we reduced exposure to Takeda Pharmaceutical and in emerging markets, given the positive performance in Peru, the fund reduced duration there.

Outlook

The fund's overweight duration position has moved lower, with markets pricing in an aggressive easing cycle in the US which would be suited to a significant deterioration in economic growth. The Fed's ability to front load cuts may be limited by key event risks such as the US elections and escalating conflict in the Middle East, making the November meeting as uncertain as September.

We continue to expect a slowdown in growth alongside a period of consistent monetary easing, however favour being long rates in countries such as the UK and Australia, where less has been priced in. To put the size of the US yield, move and our positioning adjustment into perspective, the fund was 1.0 years long US duration at the end of June, and is 0.2 years long now. The 10-year Treasury yield has moved just over 60 bps lower over that period. The fund is neutral on EUR duration and long GBP and AUD. We prefer curve steepening trades, which are positive from a carry perspective.

Corporate bond markets still trade at historically tight levels and, with limited carry and an asymmetry of how spreads may change in the broad range of potential macro and geopolitical developments, we continue to be underweight.

In emerging markets, from a duration perspective, the fund is broadly in line with the benchmark; the majority of overweight positions are in Latin America (Uruguay) as well as Indonesia.

In terms of currency exposures, the fund's largest, active, single currency exposure is in the yen. In emerging market FX, the main long positions are in the Indonesian rupiah and select currencies across Latin America.

M&G Investments

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Application forms

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