CORONATION
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Please note that the commentary is for the US dollar retail class of the fund. The feeder fund is 100% invested in the underlying US dollar fund. However, given small valuation, trading and translation differences for the two funds, investors should expect differences in returns in the short term. Over the long term, we aim to achieve the same outcome in US dollar terms for both funds.

Elevated policy uncertainty is currently one of the key elements of financial markets. The US-China trade tensions have persisted for well over a year now, and the prospect of a deal seems as elusive as ever. Trade volumes and the industrial sector have been badly hit and developed market bond yields have, to date, reflected this, with yields falling in sync with manufacturing Purchasing Manager Indices. Equities and credit spreads, meanwhile, have been more resilient and more reflective of consumer activity which, to date, has remained more robust. Having tried to withdraw support, central banks are once again lending support to markets via easier monetary policies. The fund returned 0.76% over the third quarter of 2019 (Q3-19) and 3.01% over the last year, against a benchmark return of 0.62% and 2.83%, respectively.

The action of the US administration remains the key driver of global markets. To date, the US has applied tariffs to $550 billion of Chinese goods and the Chinese have retaliated by placing tariffs on $185 billion of US goods. The impact of the protracted trade tensions is now broadening as depressed business sentiment begins to weigh on labour markets. If no resolution to the trade dispute is forthcoming, it seems likely consumer spending will begin to soften and the US Federal Reserve Board (the Fed) will reduce the Fed Funds Rate further, vindicating the market's pricing.

The Fed finds itself in a difficult position, trying to articulate an economic view that is, to a large degree, driven by politics, without itself being drawn into the political debate. US President Donald Trump, meanwhile, seems less reserved in crossing the boundaries and commenting on monetary policy. Having cut the US Fed Funds rate by 0.25% in late July and again in mid-September, the Federal Open Market Committee (FOMC) has shown it will act when it is deemed necessary.

The market now forecasts another 50 basis points (bps) of easing over the next six months and 75bps during the next year. US ten-year yields fell 32bps during the quarter to 1.66%, while thirty-year maturities reached a historic low of 1.9% in late August, as the US term premium continued to move into more negative territory. Real yields moved by a lesser extent (5-year down just 4bps) as medium-dated break-even rates of inflation (5-year down 20bps) fell to the lowest level since 2016. The fund increased its exposure to inflation-linked bonds, as it expects an easier stance from the FOMC to anchor inflation expectations in the medium term.

While US treasuries remain the highest-yielding developed market government bonds in local currency terms, this changes significantly if bonds are hedged. In the case of the US, the relatively high short-term rates versus other markets mean there is a significant pick up associated with the foreign exchange transaction. This means many lower-yielding bonds yield more in US dollar terms after hedging. The hedging effect has increased recently as a shortage of dollar funding has pushed up US interbank spreads, widening interest rate differentials. A good example is short-dated Japanese bonds that yield minus 0.3% in yen but 2.4% in US dollars. The fund has taken advantage of funding opportunities in Australian dollars, yen, pounds sterling and euros during the quarter. Overall duration remains short, reflecting our cautious view, but also the inversion of the yield curve out to five years. An inverted yield curve means 2- to 5-year bonds need to rally from current levels to outperform current short rates.

Within Europe, challenges continued to mount during the third quarter. Economic data surprised to the downside as global trade and capital expenditure volumes withered. German manufacturing expectations are now on a par with the height of the Eurozone crisis and their weakest since the Global Financial Crisis. While Germany has had to contend with the ongoing effects of the diesel emissions scandal, tariffs levied by the US in relation to Airbus, along with Brexit, present challenges for the wider Eurozone. Before handing over the presidency of the European Central Bank (ECB) to Christine Lagarde, Mario Draghi introduced more stimulus, cutting the deposit facility by 10bps to -0.5%; introducing measures to provide relief to the banks (deposit-tiering and improved terms for long term repo operations); as well as resuming the ECB's bond-buying programme (quantitative easing - QE) by €20 billion a month from November. With the ECB's latest foray into bond-buying having been opposed by seven of the twenty-five members of the Governing Council, it is not surprising that Draghi has admitted that monetary policy is nearer its limits and that future stimulus may need to come from more accommodative euro area governments' fiscal policies. There are signs the message is being heeded, but a more accommodative stance in Germany remains key. The fund has added some short-dated euro-denominated bonds to the fund on a hedged basis, but longer-dated bonds are less attractive versus US equivalent instruments.

While all outcomes (an extension or second referendum included) are potentially still on the table in the UK, a 'No Deal' Brexit remains a key risk. A deal at the EU summit on 17 and 18 October now appears unlikely, and the new 'Benn Act' will compel the UK government to request an extension to Article 50 (probably to the end of Jan 2020). While the EU has no obvious reason to refuse (apart from scepticism that the extra time will not engender any new political resolve to achieve a deal), the extension will lay the groundwork for a new general election. A small parliamentary majority for the Conservatives where hard-line Brexiteers hold sway would be the most damaging for UK assets. As it currently stands, the betting markets believe a hung parliament is the most likely scenario and, as such, a deal remains theoretically possible. The fund remains generally cautious on UK assets, with the economic consequences of a no-deal Brexit high.

Corporate bonds once again outperformed government bonds (by around 0.5%), as a combination of central bank easing, a resumption of QE in Europe and resilience in equities continued to fuel investor demand. Higher-quality instruments performed best, but this was largely a function of their longer duration. In spread terms, it was shorter-dated instruments and BBB bonds that tightened most. Corporates responded to the health demand backdrop, issuing a record €70 billion of investment-grade bonds in Europe during September. Annual issuance is on target to reach €450 billion in 2019. In the US, September was the third-highest month on record for investment-grade issuance. With 130 deals amounting to $158 billion of supply, annual issuance will likely reach $1.2 trillion. Financials continued to perform well, with corporate sectors relating to trade (industrials - such as Autos) and sectors impacted by regulatory actions (such as Tobacco) lagging.

One feature of 2019 has been the continued compression in swap spreads (now negative beyond two years) reflecting demand for duration hedging overlays alongside greater US Treasury supply and selling by overseas investors. Tighter swap spreads have resulted in increasingly tight valuations and limited value in high-quality instruments (that trade versus swaps) like Supra-nationals and covered bonds. Movements in swap spreads also impact the relative attractiveness for fixed versus floating rate bonds; at present, we see some value in shorter-dated floating rate notes (FRNs), but longer-dated fixed instruments look more attractive versus floating in our opinion.

Discussion continue apace to replace (from 2022) the discredited Libor benchmarks with $200 trillion of notional contracts linked to Libor (including FRNs) in the US, this involves migrating to the relatively new secured overnight financing rate (SOFR) that is transaction-based rather than judgement- (quote-) based. The intention is that contracts that extend beyond 2021 will use agreed fall-back language to adjust payments for the remaining life of the contracts. While consultations are still underway and the methodology has not been fully agreed upon yet, initial indications are that for agreements (in the fund's case, FRNs) shorter than five years (which covers all our current holdings) the differences at the transition point in 2022 will be negligible.

The FTSE EPRA Nareit Global Real Estate Index returned 4.9% during the quarter, with Japan the strongest region (up 13%), followed by Europe (up 9%). Unsurprisingly, Hong Kong was the weakest region over the period. While the macro backdrop is challenging for tenants of all types (office, residential and retail), lower bond yields continue to provide support. Globally, the retail sector remains most challenging, with Brexit compounding problems for UK companies. The fund has a 2.6% weighting in listed property - slightly higher than at the end of June after buying back into the US-listed Simon Property Group.

The fund marginally increased its interest rate risk profile (duration) during September but it remains very conservative, given the inverted US yield curve. Credit risk has reduced marginally, and the fund still retains some credit protection to mitigate adverse movements in credit spreads. Our holdings of non-US domiciled instruments has increased recently as movements in foreign exchange markets have given rise to opportunities to hedge instruments into US dollars at attractive levels. The fund continues to hold extremely liquid instruments, allowing us to take advantage of opportunities that may arise as a result of the macro uncertainty.

Portfolio managers
Stephen Peirce, Nishan Maharaj and Seamus Vasey
as at 30 September 2019