Please note that the commentary is for the retail class of the Fund.

Asset class performances

The second quarter of 2025 (Q2) may well prove a crossed line in the sand whereby the US became a lasting source of global financial market instability, rather than the customary refuge from such flare-ups. But it's far too early to tell; history will be the judge of that. The increased regularity with which the current US administration curtails initial policy forays has become a notable feature of its own. This is helpful, in that the sway of financial markets is not lost on these policymakers, but it still remains problematic as a modality for introducing changes. The erratic and experimental nature of such interventions is creating a requirement for previously unrequired risk premia across wide swathes of assets with sensitivity to US economic activity and regulation.

Against this backdrop, the Fund returned 1.3% for the quarter against the benchmark return of 1.2%.

The US Federal Reserve (the Fed)'s job became especially complicated during April. The retaliatory tariffs announced on "Liberation Day" ushered in a new form of engagement between the US and its external trading partners. Even as most of the initial tariff levels imposed were reduced or postponed by mid-April, it was the erratic nature of these policy injunctions that complicated monetary policy. The Fed wisely adopted a precautionary stance. The net result was the Federal Open Market Committee (FOMC) on hold, with the policy rate unchanged at 4.25-4.50%. Economic data varied over Q2, although the labour market in particular held up well. Inflation remained well behaved, although still at slightly higher than comfortable levels for the Fed (with core Personal Consumption Expenditures 2.7% y/y in May). Surveyed inflation expectations rose substantially as consumers feared the impact of tariffs. Pass-through pricing evidence remained patchy during the quarter, with it being too early to see the aggregate effects of tariffs. FOMC members continued to signal two additional rate cuts were likely over the remainder of 2025.

The front end of the US yield curve remained anchored, although yields were periodically dragged even lower as additional rate cuts over the next two years were accumulated by the market. Longer maturity yields in the US increasingly came under the sway of rising fiscal concerns. Policy signals provided by the new administration leaned heavily towards sustained higher government deficits on a multi-year basis. Spending cut efforts – like that of the short-lived DOGE (Department of Government Efficiency) – were quickly viewed as smoke screens by the market and not serious attempts at fiscal curtailment. These concerns were further deepened as information surrounding the extremely substantial spending and tax bill ("One Big Beautiful Bill") dribbled into the light over the quarter. The result has been a bear steepening of the US Treasury curve, alongside the loss of the last triple-A credit rating held by the US from one of the major rating agencies.

Global bond markets were influenced by developments in the US, but the extent of this was diluted. The German yield curve saw modest bull pivoting over the quarter, as very long-dated yields remained pregnant with an elevated fiscal/borrowing risk premium and were unchanged for the quarter. In contrast, shorter-dated euro interest rates declined, reflecting the 25 basis points (bps) cut in the European Central Bank (ECB)'s refi rate from 2.65% to 2.4% and expectations for additional cuts in the ensuing months. In the UK, a similar dynamic unfolded: the sterling yield curve reflected ongoing concerns around the potential lack of fiscal temperance in the long end; the 30-year bond yield ended at 5.16%, exactly where it started Q2. And short-end yields declined, reflecting the cut in the Bank of England (BoE) base rate from 4.5% to 4.25% in May and expectations for further meaningful easing in the quarters ahead. As is mostly the case, the Japanese bond market danced to its own tune, with the yield curve pivoting around the 10-year point as shorter-dated yields moved fractionally lower on the quarter and very long-dated bonds sold off considerably. Political pressures surrounding tax cuts, stimulus measures, and currency undercurrents influencing repatriation flows, as well as uncertainty around the Bank of Japan (BoJ)'s influence on supply/demand dynamics in the ultra-long-dated funding market, saw meaningful bond market volatility and unusually wide trading ranges for Japanese government bonds (JGBs) over the quarter. The BoJ chose discretion as the better part of valour over Q2 and kept the effective policy rate on hold at 0.5%, adding another extended pause to an already prolonged normalisation cycle.

A fair degree of variation was visible across global inflation-linked markets in Q2, although it was a positive quarter overall. The US was the outlier with a very sub-standard total return of 0.5% for Q2. Short-dated US real yields corrected sharply higher as excessive monetary easing was priced out, while longer-dated real yields adjusted higher, reflecting the same fiscal risk premium concerns shared with their nominal counterparts. The best-performing Developed Market (DM) linker market over the quarter was Italy (+12.2%) – real yields here compressed across most of the curve, bar the very short end.

A reasonable aggregate outcome for Emerging Market (EM) hard currency bonds was notched up in Q2: +3.3% in total returns. But this papers over an especially tumultuous month in April, as the aggregate market spread widened from c. 330bps towards the end of March to a daily close peak of just under 400bps – all in the wake of "Liberation Day". In this sense, a particularly opportunity-rich quarter for the asset class, albeit an opportunity that hinged entirely on the policymaking impulses of an individual. So arguably, this was not a high-quality risk-taking environment. The very weakest sovereign credits performed the best (C-rated countries returned +8.9%), with an outlandish performance from Ecuador (+48%). This sovereign has been under pressure for some time and experienced a near-complete collapse of confidence with the imposition of a state of emergency in the run-up to the second round of national elections. The re-election of the incumbent and positive overtures made towards the IMF helped euro-bond pricing rebound from gutter levels.

The local currency EM sovereign debt asset class saw a lovely bounce in Q2 (+7.6% from +4.3% in Q1). The index yield at quarter end was 6.01%, down slightly from 6.3% at the end of March and 6.39% at the start of the year. Here, broad-based currency gains really came to the fore, as the US dollar suffered against practically all other counters (except for those of India and Turkey) following "Liberation Day" and the meteoric rise of widespread doubts surrounding "US exceptionalism". Overall, there were six (out of 19) of the primary local EM sovereign debt countries that notched up double-digit returns in Q2. An impressive run, and more so, as this market showed unusual resilience in the face of the unleashed trade war and ensuing volatility. Only three sovereigns had negative capital returns in local terms: the Dominican Republic, Serbia, and Romania.

Global spread products generally followed the same pattern over Q2: an initial cascade of sharp weakness during the first two weeks of April, followed by a recovery for the remainder of the quarter. Indeed, most credit markets actually ended up modestly tighter in spread terms by the end of June relative to the end of March. US Investment Grade corporates returned +1.1% in excess returns over Q2 – the strongest quarter in six – and +1.8% in total returns. The US High Yield market had a strong period, returning +3.6% overall and +2.2% with interest rate risk hedged. European Investment Grade provided +1.7% total return (TR) and +0.5% excess return (ER), while European High Yield managed +2.1% TR and +1.1% ER. From a historical perspective, many credit markets once again see their spreads around the levels reached in the post-Covid extremes of monetary stimulus, although not quite at the lows seen in the first couple of months of this year.

Like most other risk assets, listed real estate counters experienced a dramatic drawdown at the start of April, before a quick recovery to prior levels by the first part of May. The FTSE/EPRA NAREIT Global Real Estate index saw a drawdown of c. 11.2% but ended up +3% over the quarter as a whole. This placed the YTD total return outcome (in USD) at +4.7% and the 12-month gain at a reasonable +12.4%.

Fund activity

With respect to Fund activity over the quarter, as is mostly the case, the bulk of transactions related to the recycling of existing exposures that had drifted into modestly expensive territory and were replaced by new issues perceived to be relatively cheaply priced. This tends to occur within the higher-rated credit buckets involving short-dated issues (usually one to three years). There is also the natural recycling of maturing issues, given that the Fund tends to have a meaningful and continuous liquidity ladder spanning from one quarter to the next.

Fortunately, the Fund was defensively positioned at the advent of "Liberation Day" and was well placed to weather the panicked collapse of many risk assets that occurred immediately. This provided a good platform for the Fund to accumulate better-priced, high-quality credits. This was initiated alongside an accumulation of additional US dollar base rate exposure, especially that sensitive to monetary policy easing. For while the sharp spike in credit spreads provided a longer-term opportunity for the Fund to harness value, the uncertainty provoked by the tariff war shock created economic risks in the short term. Hence, adding additional emphasis on defensive exposures positively oriented towards monetary policy easing was prudent. With the sharp reversal and postponement of most of "Liberation Day's" impositions, monetary policy pricing of emergency relief was quickly tapered, which squeezed the value of these insurance buffers accumulated by the Fund. However, the unexpectedly sharp gains from the additional credits accumulated more than made up for the negative duration impact. The net result was that the Fund posted a positive return during April, despite the scale of the financial markets shock experienced.

Indeed, the recovery was so rapid over the quarter that pricing has – once again – widely veered into over-stretched territory for exposures across most spread asset classes and other risk-oriented fixed income assets. Hence, by the end of the quarter, the Fund was more inclined to trim such exposures, rather than add.

Portfolio managers
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as at 30 June 2025