Fund report, July 2022
Global Investment Grade
Fixed Income

Sparinvest

INTEREST RATES DECLINED ON RECESSION FEARS

Credit spreads supported by declining interest rates

Markets. Almost all financial asset classes delivered high returns in July. The interest rate decline in the last half of June continued into July. On the back of the monetary tightening in the first half of 2022, market focus shifted to the impact of the higher interest rates on the economy. Long-term yields started declining on market expectations that central banks would not be able to raise interest rates much more without pushing the economy into recession. The declining interest rates could be seen as a reverse interest rate shock, which eases the tightening of the financial environment predominant so far in 2022.

The Federal Reserve raised interest rates by 0.75% in July, and the ECB surprised the markets by raising rates by 0.50% as opposed to the expected 0.25%. The ECB seized the opportunity to get off to a quicker start than initially planned, presumably in expectation of having to abandon its tightening cycle sooner than scheduled due to the current state of the economy. At the end of June, the markets expected that the ECB deposit rate would be about 2% in mid-2023, but expectations had dropped to 1% by end-July. The prospects of a more lenient monetary policy going forward have supported credit spreads in July.

The majority of the key indicators plunged in July – in relation to not only manufacturing but also the service sector. This was reflected in the Composite PMIs from S&P, which includes both these parts of the business sector. In the U.S., the index shrunk from 52.7 in June to 47.5 in July. In Europe, the corresponding index dropped from 52.0 in June to 49.4 in July. Both indices have now dropped below index level 50, which typically signals whether business activity is trending up or down. Reports also showed that the relationship between order intake and inventory build-up deteriorated further in July. This supports the reports from several companies of rising inventories following order cancellations.

Recent data from the household sector suggest that consumer demand has dropped considerably within a short period. This indicates that the higher prices of goods now seem to feed through to consumer behaviour. In the U.S., retail trade in the early summer was 3-4% lower than the same period in 2021 (in real terms). In terms of current prices, retail trade has risen by 8%. Recent data from Germany show the same trend. In June, retail trade dropped by 9% in volume and by 1% in current prices compared with the levels in 2021. In recent time, we have only seen negative consumer behaviour of this magnitude in connection with the financial crisis or the corona crisis. Overall, this suggests that the deteriorated growth outlook in the OECD area is now driven by demand and partly triggered by a relatively large decrease in real wages.

Credit spreads decreased by 27bp and 13bp, respectively, for European and U.S. IG bonds in July.

Lower interest rates and credit spreads generated positive performance

The portfolio yielded positive returns in July, driven by lower credit premiums, which were supported by lower interest rates.
Following high uncertainty in the first six months of the year, July supported credit spreads, which tightened evenly across credit ratings. In the first half of 2022, credit spreads of European IG bonds widened more than their US equivalents, but European IG bonds were the best performers in July. Due to the diving interest rates, long-dated bonds generated the highest returns.
The portfolio is overweight Europe vs the U.S., which contributed positively to the excess return on the portfolio. The portfolio is slightly underweight in duration, which made a negative contribution to the relative return in a month with declining interest rates. Overall, the portfolio generated a positive excess return in July, and the relative return was also positive for 2022.

See performance and fund data Click here >

Strategy
Global Investment Grade invests in global corporate bonds, cf. the fund's prospectus. Bond selection is based on the value approach, meaning that the team focuses on bonds issued by companies with healthy long-term earnings power and strong balance sheets as well as an expected ability to service outstanding debt. The portfolio is diversified across sectors, regions and credit ratings. At least 2/3 of the portfolio are invested in Investment Grade bonds.