# Quarterly Commentary

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"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us, we were all going direct to Heaven, we were all going direct the other way—in short, the period was so far like the present period, that some of its noisiest authorities insisted on its being received, for good or for evil, in the superlative degree of comparison only."
Charles Dickens

### Geoeconomics: Adapt or Die

As Dickens suggested in his famous novel, we live in an era where the narrative is told only in superlative terms: global warming and extreme climate events, the end of globalization and geopolitical multipolarization, the end of Pax Europaea and the nuclear threat, misinformation and censorship, the weakening of democratic institutions and polarization of the electorate, migration crisis and inequality, attacks and terrorism, subsidies and tariffs, supply chain and raw material risks, inflation, and the potential risks of AI are just some of the issues that have kept us on alert in recent years. **Only the strength of the American consumer and the resilience of its labor market have acted as the sole anchors in an otherwise grim story.**

In the midst of this discouraging landscape, marked in recent years by high-risk events and elevated volatility, we have also witnessed some of the best performances in both stocks and bonds, with annual returns reaching +25% and +7%, respectively. This is thanks to past, but also expected, liquidity injections from central banks (Fed put). Despite this, we warned in our last note of the risks we foresaw as the vacation period approached, and as the U.S. election season neared, with the possible increase in volatility due to the loss of liquidity in a high-valuation and highly leveraged risk environment.

In just three months since our last commentary, we have once again witnessed these stark contrasts: with the historic Labour victory in the UK and the electoral upheaval of the far-left in France, we have also seen the unprecedented rise of the far-right in Germany and Austria; with Biden's withdrawal from the presidential race, there were two assassination attempts on Trump; alongside the relentless bombing in Gaza, we witnessed large-scale "selective attacks" on Hezbollah; as Russia invaded Ukraine, Ukraine also invaded Russia (Kursk); and against the constant decline of the yen, there was the historic explosion of volatility caused by the unwinding of the carry trade par excellence.

An unexpected rate hike by the BoJ, combined with a more dovish Fed in response to weaker manufacturing and employment data, hit the weakest link: the yen. The unwinding of the carry trade triggered a historic volatility spike, once again highlighting the fragility and interconnection of the global financial system and the need for proper risk management to successfully navigate high-risk, high-probability events. Investors, interpreting the deleveraging as a liquidity issue rather than a credit crisis, returned equity indices to record highs in just two weeks. Meanwhile, the fixed income market, discounting a new growth trajectory, priced in almost 10 quarter-point rate cuts for the coming year, steepening the curve sharply.

In the meantime, we've learned that the American labor market wasn't as strong as we had been told. A revision showed nearly one million fewer jobs, reducing growth by almost 30% (laugh at the quality of Chinese data). Additionally, about one-third of the jobs created in the past year were government jobs (as could only be expected in an election year). Even Powell had to admit that the reported data may have been overestimated, increasing the risk of extreme movements in response to future weaker data.

On the consumer side, not everything is as it seems either. While there is a narrative of resilience in the American consumer, it comes at the cost of a savings rate at historical lows (only surpassed in the years before the Global Financial Crisis of 2008). More than half of Americans are unable to cover an unexpected $1,000 expense. The most worrying aspect may be the rapid deterioration in credit card and auto loan delinquencies in recent quarters, which are beginning to set off alarms on Wall Street.

In the past three months, we have also witnessed the need to stimulate economies through "coordinated" rate cuts by more than 20 central banks globally. Once the Fed opened the door with a significant rate cut, the first to release the "animal spirits" was China, letting the genie out of the bottle.




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During this time, we have also seen how doubts about the sustainability of China's growth have fully impacted commodity and energy prices, with China continuing to be a source of deflation for the entire world. The latest measures announced last week highlight the concerns of Chinese authorities, in response to the snowball effect that sharp corrections in the real estate market and stock market have had on the Chinese consumer. We fear that as long as tensions around Taiwan persist, it will be difficult to attract foreign capital and investment back into an economy unable to stimulate its internal demand.

Finally, the much-anticipated Draghi report has been published, which outlines the difficult situation Europe faces in implementing its decarbonization and rearmament plans. These will require vast amounts of both public (with a Franco-German axis becoming increasingly polarized) and private capital (with a constrained banking system and stagnating companies with significant capex needs), summed up in three words: adapt or die.

Now that doubts about the magnitude of the Fed’s first rate cut in years have been dispelled, the only hurdle left is crossing the Rubicon of the U.S. elections, for which the Fed has already built a solid bridge. It is expected that, once the results are in, the fiscal stimulus we’ve grown accustomed to from the Biden administration will start to fade, as is often the case with our leaders after a major electoral milestone. Therefore, despite the return of global liquidity injections, it would be wise to continue exercising caution, as Bob Dylan once sang: “He not busy being born is busy dying.”

## PERFORMANCE

The fund achieved a +2.75% return in Class A during the third quarter, compared to a Bloomberg Barclays Global Aggregate return of +6.98%.

As we warned at the end of last year, 2024 was expected to be a year of gradual improvement, and the third quarter has not disappointed in this regard. An unexpected rate hike by the BoJ, combined with a more dovish Fed in response to weaker manufacturing and employment data, served as the catalyst for the sharp repricing we’ve seen in the short term. Add to that the historic volatility spike in August from the unwinding of the yen carry trade, the Fed's decisive 50 basis point rate cut, and the increase in hostilities in the Middle East in September, and it’s no surprise that investors have sought refuge in fixed income.

During the quarter, the impact of the unwinding of the carry trade in emerging markets was the factor that weighed most on the fund's performance, particularly in Mexican government debt, although all strategies generally contributed positively to the fund’s returns. It is worth noting the strong performance of both zero-coupon AAA supras in Mexico and South African government debt, which benefited from the noise surrounding the judicial reform in Mexico. In terms of performance, the strategies that contributed the most to the portfolio's returns were those linked in some way to the decline in U.S. real interest rates, such as inflation-linked bonds, long-term positions on the U.S. yield curve, and dollar hedges. Significant returns also came from financial credit, both in senior and subordinated debt. On the negative side, convertible bonds, Mexican government debt, and 10-year UK government debt were the positions that detracted the most from the fund’s performance.



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## POSITIONING AND OUTLOOK

During the quarter, we continued to slightly increase the duration, reaching 6 years, taking advantage of corrections in the long end of the U.S. and U.K. yield curves. In terms of the dollar, we slightly reduced exposure to 4.6% as rate differentials narrowed.

In terms of specific names, we took profits due to narrow spreads amid rumors of a takeover at Lar. We also reduced exposure to corporate hybrids such as Repsol, Total, and Eni, given the low spreads they offered at the call. On the sales side, we also took profits in some frontier markets: Ukraine, Romania, and Hungary. On the buying side, we increased the portfolio’s duration through long-term positions on the U.S. curve with names like Intel and Prosus. We also continued to increase our position in U.K. government debt, this time through 2-year and 20-year bonds. In Europe, we added long-term positions on the Italian curve. From a high-yield perspective, we incorporated senior secured debt from Eroski.

We continue to favor quality over subordination, especially given the narrow spreads and asymmetric risks presented by high yield in a declining economic and geopolitical environment. Despite the excessive cuts predicted by short-term yield curves, we believe the deflationary process should continue to unfold as real interest rates keep declining.

At the end of the quarter, the portfolio's yield to maturity stood at 5.0%, with a duration of 6 years and a cashflow coupon of 3.1%. The portfolio’s weighted average price is 89.2 cents per euro, with a 4.6% exposure to the dollar.



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