

NEI Global Total Return Bond Fund

Q4 2023 Commentary



Performance

The Fund (Series I) outperformed its benchmark over the quarter.

The final quarter of the year was a tale of two halves. October started with an unexpected attack by Hamas on Israel. Initially bond yields fell sharply as investors fled to safe assets, however the direction soon reversed. The US CPI print came in at +0.4% month-on-month with core CPI hitting a 5-month high of +0.32%, notably above consensus expectations. It was a different story in Europe, where inflation and economic data continued to show signs of weakness. Yields moved lower on the back of these developments, especially at the front-end of the curve, as was the case in the UK.

In November there was a big reversal in the market's expectation of inflation and the resultant central bank policy tightening required to dampen pricing pressures. The FOMC maintained the fed funds rate at 5.50%, acknowledging tighter financial conditions from higher yields, despite a strong acceleration in economic activity in the previous month. Weaker data through November helped to fuel the 'end of hiking cycle' narrative. Later in the month, a small miss on US CPI caused another bond and risk rally, with any further rate hikes fully priced out.

The positive trend continued into December with economic data releases continuing to support a downward trend in inflation, and the Fed signalling towards a number of interest rate cuts in 2024. Bond markets moved to price in a higher likelihood of a soft landing in the US, expecting inflation to return to 2% quickly without a significant deterioration in the labour market and an associated recession. The European Central Bank (ECB) kept interest rates unchanged, but importantly Christine Lagarde was at pains to point out that rate cuts had not been a topic of conversation.

Returns

Fund	3 months	6 months	YTD	1 year	3 years	5 years	10 years	Since inception ¹
NEI Global Total Return Bond Series I	5.52	5.01	8.48	8.48	1.20	3.54		3.70
NEI Global Total Return Bond Series A	5.03	4.04	6.50	6.50	-0.65	1.65	1.82	1.85
NEI Global Total Return Bond Series F	5.25	4.48	7.41	7.41	0.18	2.51	2.71	2.76
<i>Benchmark 1: Bloomberg Global Aggregate TR Hdq CAD</i>	5.67	3.60	6.33	6.33	-2.47	0.98	2.22	2.21

¹Source: Morningstar. As of Dec 31, 2023. The benchmark since inception return in the table is calculated as of the inception date of Series A. Since inception benchmark returns for Series F and Series I are 2.21 and 2.04, respectively.

Portfolio commentary

During the fourth quarter of 2023, G10 Sovereign bond positions made a negative contribution. On specific underlying levers: Duration - an underweight positioning was one of the main detractors in a quarter where the Fed have signalled 75bps of rate cuts in 2024, which helped trigger a substantial US duration rally. Country allocation - overweight duration in NZD, MXN and ZAR were the main contributors here. Yield curve - steepening positions in the US and European curves delivered negative performance as the long-end rallied more than the short end. Bond selection - underweight to France contributed negatively and there was positive contribution from overweight to Spain and Italy. Credit positions made a positive contribution to relative performance. An overweight exposure to Financials in particular was the largest positive contributor as the sector performed well again in Q4. Emerging markets - overweight allocations to emerging market hard currency bonds was a small positive. Currency positions were negative contributors to relative performance.

During the quarter, the sub-advisor increased underweight duration position, moving from -0.7 years to -2 year as they believe that the rally in duration witnessed during November and December is overdone. They were tactical in managing the US duration during the quarter but remain underweight and even increased the size of the position towards the end of the period. They re-opened the underweight in European and Canadian duration. They retained underweight duration in

Japan as they believe the risk/reward is still very asymmetric. They increased the overweight duration in Australia and moved from neutral to overweight. They kept a steepening bias in both US and European duration as they think long end of the curves have rallied too much and they expect curves to steepen in the medium term. They still have small long duration positions in some EM curves where they believe central banks are likely to cut rates (Brazil, Mexican and South Africa) and on the New Zealand and UK curve, where they believe the upwards rates adjustment may have been overdone. In FX, they moved from a small short to a long in USD, from -0.6% to 3.6%. They increased the underweight CAD from -4.2% to -7.2%. They reduced the short EUR from -4.4% to -2.8%. They trimmed the long NOK from 6.7% to 5.6% following the recent strong performance, but remain long. In EM, they closed the long KRW initiated the past quarter.

Outlook

The subadvisor believes monetary policy is entering a new phase and the global monetary policy tightening cycle is now behind us. Markets are now pricing interest cuts in the US and in the Eurozone starting from March. While the subadvisor agrees that we will most likely see rate cuts in 2024, they believe the market is now pricing cuts too soon, as growth has remained very resilient in the US and core inflation measures are still well above targets. In the short term, the subadvisor expects the strong rate rally in the last two month of the year may lead to some pull back; hence, they remain tactical and underweight headline duration for now.

In Japan, the subadvisor expects upward pressure on yields through 2024. The BOJ appetite to keep buying JGB's to defend target is waning. They believe the end of the negative interest rate policy is likely in 2024, and hence they remain underweight in Japanese duration.

In credit, the subadvisor still likes Investment Grade where fundamentals remain resilient, although management guidance is starting to be lowered. They currently prefer the belly of the EUR Investment Grade curve on valuation grounds. However, High Yield corporates look expensive in their view, in the face of the deteriorating growth outlook, and they remain cautious in that segment.

The subadvisor remains cautious in Asia, where they expect lower growth, in particular from China, and greater geopolitical uncertainty. The election agenda is heavy in 2024, including election in the US, which could bring about some volatility. They expect these factors, combined with the lagged impact of divergent monetary and fiscal policies across economies, will bring about several relative value and tactical opportunities to generate outperformance in 2024, in addition to the directional strategies implemented in the portfolio.

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