Pyrford

Part of COLUMBIA THREADNEEDLE INVESTMENTS

ARSN 168 994 205

For wholesale investors only

CT Pyrford Global Absolute Return Fund (AU$)

31 March 2024

Q1 2024 Commentary

Firm Update

Firm AUM at the end of the period was AUD$ 12.48bn.

There were no changes to the investment team.

Performance

The fund returned 3.82% net of fees over the quarter. Since inception in June 2014, the fund has delivered 5.37% per annum.

The aim of the fund is to provide a stable stream of real total returns over the long term with low absolute volatility and significant downside protection.

Market Environment

The opening quarter of 2024 saw several equity markets climb to record highs with bond markets selling off as investors recalibrated expectations for rate cuts with fewer cuts priced further down the line. The US 10 Year Treasury Yield climbed from 3.88% to 4.20% over the course of the quarter.

The US, Japan, Europe and India all hit record highs over the month as investors optimism on future rate cuts remains in place despite pushing back the magnitude and timing of central bank rate cuts. The S&P 500 was first to reach the milestone led by the strength of the tech sector although momentum has been weaker of late as mixed economic data caused the market to reassess when the Fed will start cutting rates.

Europe's Stoxx 600 has taken just over two years to climb back to all-time highs, a mere blink of an eye compared to the Nikkei 225 in Japan which last hit its peak back in December 1989. Whilst both markets now sit at record highs, Japanese equities have been attracting flows whilst European equities have seen outflows since the turn of the year. Of course, valuations need to be considered. Japan is trading at a P/E multiple 16.3x, broadly in line with its 10-year average. Europe is trading on a P/E multiple of 14.8x, close to 20% discount to its 10-year average. Not all record highs are equally loved.

Key Drivers & Detractors

Positive performance was achieved across all domestic and overseas allocations. Led by overseas equities and closely followed by domestic equites and overseas bonds and then domestic bonds. This quarter our currency hedging program detracted.

Contributions from domestic equities were led by Computershare, Brambles and QBE this quarter. Computershare's performance this quarter has been largely driven by the rebound in bond yields since the end of December. Interest rates are important to the company as it earns income on client funds as they flow through its infrastructure, for instance as it distributes a dividend, paid in bulk, to a listed company's individual shareholders. However, the market can fixate on this at the expense of other developments at the company which are also positive. These include successful cost-savings programmes, a recovery in "event" based activity e.g. processing a merger, and the strength in the company balance sheet following the sale of the US mortgage servicing business. This gives management the option of investing in bolt-on acquisitions or increasing returns to shareholders. We consider management to have been successful at deciding between these two in the past. Brambles reported good results in late February. The company has been very successful at passing on price increases which reflect the cost pressures they have faced over the last 2 years. Net profit for their first half (the company has a June year-end) was up 18% on the same period last year, and the interim dividend was increased in line with this. Free cash flow was also very strong because the need to invest in new pallets has fallen as retailers reduce their pandemic-era levels of emergency inventory. The market was particularly impressed that the company took the opportunity to increase its profit guidance for the second half of the year, some investors had assumed that earnings had peaked. At our recent meeting with the CEO we learned of the potential growth opportunities from new clients who Brambles couldn't sign up when there were shortages of pallets, but this is finely balanced as excess returns of empty pallets imposes transport and storage costs if they cannot be quickly reissued. QBE added after reporting results broadly in line with expectation with underwriting profits providing a slight beat and cost of risk (94.6%) matching prior guidance. The North America business continues to improve with legacy, higher cost of risk, non-core portfolios in the US expected to leave in financial year 2024. Dividend yield remains attractive at 3.6%.

Within the overseas equity allocation Taiwan Semiconductor added whilst AIA Group detracted. Taiwan Semiconductor beat analyst estimates for earnings in the fourth quarter of 2023 and guided higher than expected views for the year ahead, likely boosted by increased demand for chips that can cater to artificial intelligence software. Analysts have revised price targets to higher levels as they see global AI as an obvious growth driver for the company. AIA has performed poorly since its results despite operational metrics improving throughout 2023. The company sees greater return potential from investing in the existing business rather than committing to extending the buyback that is due to complete later in the year which seems to have disappointed the market. Investment performance too has been weak for the past 2 years which raises concerns that their actuarial investment assumptions may be too aggressive. Given that approximately 60% of the business is exposed to China and Hong Kong and the current macro challenges experienced in China, investors have been shifting their allocation to more export related businesses. We remain confident about the long-term prospects for AIA given the under penetration of life insurance across the region and its strong competitive advantage with the most productive agency force across the region.

The Australian yield curve steepened over the quarter as expectations for rate cuts through 2024 were pared back. We are positioned at the short end, reducing our duration risk whilst offering an attractive coupon. We are also positioned at the short end within our overseas bond allocation. The yield curves in the UK, US and Canada steepened at the short end. Our exposure to Canadian government bonds was aided further by an appreciation of the Canadian Dollar against the Australian Dollar.

Our US Dollar and Euro exposure is hedged, meaning we did not benefit from a strengthening US and Euro.

Asset allocation & positioning

We remain defensively positioned. Our current allocation is 50% equities, 48% government bonds and 2% cash.

Within the fixed income allocation, Pyrford adopts a defensive stance by owning short duration securities to minimise the impact on the portfolio from interest rate rises. Given the recent increase in bond yields, the target modified duration was increased to 5 years. We are monitoring yields closely as since we extended duration yields have dropped sharply. Whilst these shorter duration bonds are unlikely to yield high returns, they will provide significant capital protection for the portfolio and importantly they are highly liquid. 30.6% of the model portfolio is invested in overseas bonds, with 17.5% in the US, 8.6% in the UK and 4.4% in Canada. 17.4% of the portfolio is invested in Australian government debt.

Within the equity portfolio the companies we hold are defensive names, which we would expect to perform well during volatile periods. The focus of the portfolio is on balance sheet strength, profitability, earnings visibility and value. Within Europe there are no holdings in the peripheral Eurozone countries where sovereign debt concerns remain. The European portfolio is concentrated in Switzerland and the relatively healthy economies of core Europe and the UK. In Asia, we prefer the Southeast Asian markets over Japan. The potential growth rate in Japan remains low given the poor demographics and low productivity growth. Economies in Southeast Asia offer sustainable economic growth supported by increased labor output or productivity growth and trade at more reasonable valuations.

We continue to hedge the Euro and the US Dollar to meet the portfolio target exposure of no more than 45% in non-AUD, unhedged currencies. Our hedging rule is to hedge currencies that are more than 25% overvalued relative to the base currency. Whilst the US and Euro are not more than 25% overvalued as per our hedging rule they are the most expensive currency relative to the Australian Dollar.

Quarterly ESG & Proxy Voting Summary

As long-term shareholders of companies, we have the ability, and in our view the responsibility, to try and influence the business practices of companies.

Pyrford voted 232 proposals in 11 company meetings in the quarter. We voted against management on 18 proposals. We also engaged with 71 companies worldwide and ESG issues are a standing agenda item in every meeting we conduct..

For a detailed overview of ESG activity, please visit our website for all voting records and our latest annual ESG report.

Risk disclosure

The investments and investment strategies discussed are not suitable for, or applicable to, every individual. All investments involve risk, including the possible loss of principal and a positive return is not guaranteed over any period. Past performance is not a guarantee of future results. Performance data shown in the document may not be in the local currency of the country where an investor is based. Actual returns may increase or decrease as a result of currency fluctuations. Dividends are not guaranteed and are subject to change or elimination.

Regulatory disclosure

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