Sustainable Funds

First half 2024 in review

Market Update

Global equity markets continued their strong performance in the first half of the year, led once again by US equities and, more specifically, large capitalization Information Technology stocks. However, the breadth of underlying stock performance was quite narrow with many sectors and regions materially lagging global equity indices overall, as slowing growth and higher interest rates weighed on the performance of more economically sensitive areas of the market.

Fixed income securities experienced a tough stretch of performance, as elevated expectations for central bank interest rate cuts at the beginning of the year were quickly reversed as inflation and economic growth data remained strong, causing interest rates to rise. Corporate bonds fared better thanks to the carry benefit, where total return derived from holding the bond exceeds the cost, providing higher absolute yields and credit spread compression, as corporate balance sheets remained healthy and better growth data reduced fears of default risk.

Fund Performance

Although all of the Sustainable Funds had positive performance in absolute terms in the first half of the year, led by Sustainable Growth100 Fund (which returned double-digit performance), the three equity-leaning Sustainable Funds lagged their respective benchmarks, due to the contributions to benchmark returns from a small subset of US Information Technology stocks, which were relatively underrepresented in these Sustainable Funds' portfolios. The more fixed income-focused Sustainable Funds fared relatively better, given their overweight allocations to investment-grade credit and exposure to the US dollar, which rose during the period; although rising interest rates meant that bond returns overall were fairly flat during the period.

Position Changes

Early in the year, the three equity-focused Sustainable Funds exited their position in the thematic iShares Global Clean Energy ETF to reduce interest rate sensitivity, as well as exposure to political risks, including the potential repeal of the Inflation Reduction Act in the US, which could impair the earnings outlook for many cleantech companies. To replace this holding, First Trust NASDAQ Clean Edge Smart Grid Infrastructure ETF was purchased; it is directly invested in companies that are the beneficiaries of electrical smart grid investments and electricity demand resulting from the transition to electric vehicles.

Regionally, these equity-focused Sustainable Funds closed their equity underweight allocation in Canada, after a long period of underperformance and a subsequent improvement in the underlying earnings outlook.

The three fixed income-focused Sustainable Funds increased their exposure to high-quality credit, as strong fundamentals reduced the risk of default and absolute returns were attractive. Also, these Sustainable Funds lengthened their duration exposure closer to neutral after interest rates rose in absolute terms in the first half of the year on the back of economic data being resilient.

Current positioning

The equity-focused Sustainable Funds remained biased towards high-quality defensive growth equities and sectors, such as Health Care and Consumer Staples, expecting a continued slowdown in both economic growth and inflation to ease the outlook for central bank monetary policies, which would be expected to weigh on the earnings potential for lower quality, more cyclical equities and sectors, such as Energy and Materials. Regionally, equity positioning in these three Sustainable Funds was neutral to the benchmark weights as cheap valuations of some markets were offset, to an extent, by the continued strong underlying fundamentals of other more expensive regions.

Fixed income positioning in the three fixed income-focused Sustainable Funds continues to retain a bias to high-quality corporate credit relative to government bonds, viewing absolute yields as attractive, while still modest economic growth and strong balance sheets should limit the risk of a default cycle. Duration exposure is currently neutral within these portfolios, as interest rates remain balanced between slowing inflation and still steady growth.

Current Outlook

The outlook for equity remains steady as economic growth and employment trends slow but remain strong overall. The Manager expects declining inflation rates to continue to ease pressure on central banks from having to maintain restrictive monetary policies; thereby supporting liquidity conditions and likely softening the impact of slower growth. However, a great deal of uncertainty surrounding geopolitics and the ultimate extent of the economic slowdown leads us to favour high-quality and defensive growth securities until greater clarity on these risks is achieved.

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Published: August 21, 2024