May 2022 | Investment update

Omnis Portfolio Funds Investment manager reports

For the six-month period ending 31 March 2022

We explain how the global economy and financial markets have evolved over the past six months, with individual comments about fund performance from the managers responsible for each strategy.

View from the Omnis investment team

Robert Jeffree
Chief Investment Officer
at Omnis Investments

Over the past six months, we have navigated an ever-changing macroeconomic and market environment. Following a pickup in economic growth in Spring 2021, as vaccines paved the way for economic reopening, we saw inflation pick up sharply due largely to supply chain disruptions. Central banks were initially confident that inflation would be transitory, though in reality it has been more prolonged than they expected. Over the review period the Bank of England and the US Federal Reserve began raising interest rates to combat inflation. We also began to see economic growth slow down to more normal pre-pandemic levels.

At the start of the review period, in September 2021, global financial markets were rocked by the news that Chinese property developer Evergrande would likely default on its interest payments to bond holders. In the US the S&P 500 dropped more than 4% in the month; the worst drop in over a year. In the UK the economic rebound slowed as attention turned to the impact of Brexit on the economy.

Volatility in markets continued in October as a global shortage of natural gas supplies impacted energy and fuel price across the world. October also saw the Bank of England warning that the global rise in inflation could slow the UK's economic recovery.

Markets rallied for most of November despite inflation remaining high and the economic recovery slowing down. However, this rally was short-lived as towards the end of the month, Omicron, a new variant of the coronavirus spooked markets across the world. The Omicron variant caused markets to experience a period of volatility, which lasted well into December, but despite this, most global markets ended 2021 with solid gains. The UK's inflation rate surged prompting the Bank of England to raise interest rates in December for the first time since November 2017 and the US Federal Reserve decided to accelerate the tapering of its bond-buying programme sooner than expected; both moves to dampen inflationary pressure.

Markets gave back gains in 2022 due to concerns that the US Federal Reserve would increase interest rates more aggressively to control inflation in 2022; investors began to worry that an aggressive interest rate hike cycle could harm global growth.

2022 has so far been dominated by Russia's invasion of Ukraine on 24 February and the ongoing war. From a social and political perspective, the impact will be huge. Investment sentiment has been rocked causing a marked increase in volatility that we expect will last for some time. There has already been an impact on energy prices, which will prove to be yet another headwind for economic growth around the world and further fuel to inflationary pressures. This may temper the desire of Central Banks to continue raising interest rates.

Ahead of the invasion, Omnis had become concerned about the prospect of sanctions and capital controls on Russia, which could limit our investment managers' ability to sell holdings in the region if necessary. We had exposure to a small number of Russian and Ukrainian holdings in our funds. Omnis Investments, as Authorised Corporate Director (ACD) of its funds, reviewed this exposure to Russia and Ukraine and decided to take action to ensure investors were not

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exposed to the risk of sanctions or capital controls. Omnis instructed its investment managers to sell their Russian and Ukrainian holdings immediately, and all holdings were sold before the invasion and any sanctions were imposed. We currently have no direct exposure to Russia or Ukraine and an embargo on investing in the region will remain in place further notice.

Stock markets were volatile in March, and oil and gas prices continued to soar with Brent crude reaching $139 a barrel. The International Monetary Fund and World Bank warned that increasing commodity prices are likely to fuel inflation for some time. Concerns that the world economy could suffer a period of stagflation – surging consumer prices combined with weak economic growth – also became more prevalent. The war in Ukraine has and will continue to affect financial markets, as investors weigh up Russian actions the economic implications of sanctions imposed. After an initial fall, share prices recovered some of their lost ground over the second half of March. The price of commodities like oil, gas and wheat eased following an initial spike higher, and reaction to the European Union's economic response to the war improved investor sentiment.

While events in Ukraine and concerns over the economic outlook might ordinarily be expected to boost the appeal of 'safe-haven' assets, including high quality bonds issued by the likes of the US and UK governments, the threat of inflation has outweighed such considerations. As a result, bonds have suffered significant losses so far in 2022.

To combat rising inflation, the Bank of England raised interest rates once again in March and, for the first time since 2018, so did the US Federal Reserve signalling that there are likely to be further rises this year. Inflation rates in the US, UK and Europe have now reached multi-decade highs, paving the way for further interest rate hikes for the remainder of this year.

Elsewhere, China's new regulations and restrictions on its tech industry caused another sell-off in its stock markets. China's top economic official responded by saying that the government would take measures to support the economy and financial markets. Following this statement, markets initially performed strongly, but have since levelled off as we are yet to see those words translate into action. Stocks in China also dropped towards the end of the period due to a surge in cases of Covid-19 in parts of the country. This could have global implications as China's zero-Covid policy means strict lockdowns are in place in many parts of the country impacting global supply chains.

Investment outlook

Despite ongoing uncertainty caused by the war in Ukraine, a degree of stability has returned to stock markets as investors perceive that some of the worst-case scenarios have become less likely. However, the unpredictability of the situation means we can still expect to see some volatility in markets for some time.

Russia's invasion of Ukraine, and China's zero-Covid policy continue to cause inflationary pressures. The invasion has elevated energy and commodity prices, whilst the localised lockdowns in China are disrupting supply chains. Both factors contribute to rising prices but there are signs that a peak in inflation is not far off. In the US, key components of inflation such as second-hand car prices are set to fall sharply. In Europe, cuts in fuel duties have been announced.

Around the world, central banks are now raising interest rates to combat high inflation after keeping rates very low during the pandemic to help boost growth. The increases are designed to limit inflation by encouraging people and firms to borrow and spend less, and to save more. Continued rate rises are signalled by the central banks in the US, EU, and UK. Should these happen, it is likely that economic growth will slow. Most central banks are mandated to control inflation, but overly aggressive rate rises could trigger a recession. In the short term, market sentiment is likely to remain extremely sensitive to events in Ukraine and the risk of recession remains elevated.

Whilst we are likely to experience further challenging periods in the short term as economic growth slows and central banks navigate the current inflationary environment, it is important to separate out the economic environment from the investment opportunities. Our funds are actively managed by our specialist investment managers who continue to search for quality investments regardless of the more challenging economic environment.

Over next few pages our investment managers share details of how they have managed their funds over the period.

Views from Franklin Templeton Fund Management Limited

Investment manager of the Omnis UK All Companies Fund

On a sector basis, stock selection in and underweight exposures to banks and basic resources detracted from relative performance. An overweight allocation to and stock selection in industrial goods and services also weighed on relative returns. In contrast, an underweight position in travel and leisure added relative value, as did stock selection in personal care, drug and grocery stores, technology, and media.

Technical translation business RWS Holdings was the largest detractor from relative performance. The company's share price fell over 39% over the period, influenced by the announcement in the first quarter of 2022 that full-year results will be toward the lower end of market expectations. Instrumentation supplier Spectris was also among the largest detractors from relative returns. The company announced in its full-year results that supply-chain issues had held back sales growth in the short term.

Diversified miner BHP Group was the largest contributor to relative results. The company's share price rose almost 30%, with a broad basket of commodities rallying on concerns over the Russia-Ukraine conflict. Consumables distribution business Bunzl was also among the main contributors to relative returns. The company's share price increased significantly in anticipation of continued strong trading performance, as evidenced in its strong third-quarter trading update published at the end of October.

In terms of activity, we made no major changes in the fourth quarter of 2021. In January 2022, we initiated a position in paper and pulp manufacturer DS Smith. As a manufacturer of corrugated packaging, DS Smith is set to be a beneficiary of the shift away from plastic packaging, as both the European Union and United Kingdom (UK) launch taxes on plastic packaging.

In February, we sold the position in life insurer Prudential, and initiated positions in asset manager Liontrust Asset Management and testing business Spirent Communications. In our opinion, Liontrust is a uniquely placed fund management business, which has achieved market-leading growth rates through successful product development and launches.

Spirent is a telecoms testing business that is geared into structural trends, such as the roll-out of high-speed internet, with net cash on the balance sheet and a multiple that we believe does not reflect the company's growth options. In March, we exited the position in contract catering business Compass Group.

Views from Jupiter Asset Management

Investment manger of the Omnis Income & Growth Fund

The last quarter of 2021 was a difficult period for value investing (the investment strategy focus) with the fund finishing that quarter behind the index but this reversed in the first quarter of 2022 with value performing well and the fund recouping much of this underperformance.

On a stock specific basis, BAE, a defence company, performed well as the war in Ukraine has prompted a re-think on defence budgets in many European countries. This will mean higher demand for BAE's products and so the shares have reacted positively. The war in Ukraine has also caused a surge in commodity prices which has been beneficial for some of our companies (e.g., Shell and BP).

Our holdings in the financial sector (e.g., Standard Chartered, Aviva, HSBC) also performed well as rising interest rates are beneficial for these companies. On the negative side, companies which are seen as being beneficiaries of the pandemic, for example Kingfisher which benefited from a rise in DIY spending, performed poorly. Capita shares were weak as the company warned about a slowdown in sales growth. ITV shares also performed poorly as they announced a significant new investment into their streaming platform which was not viewed favourably.

During the period we started new positions in HSBC, Centrica, Continental, and Intel and significantly added to our position in ITV. Intel is a US listed semi-conductor company. It is lowly valued because the company ran into issues producing the latest chip and they have lost technological leadership. However, the balance sheet is strong, market shares are still high and the industry is experiencing secular growth.

Continental is a German listed automotive supplier and tyre manufacturer. The tyres business is very high quality with high margins and low levels of cyclicality. The automotive division (45% of sales) is lower quality but they are still considered an essential partner for many European car manufacturers. Automotive profits are depressed but the tyres business alone is expected to generate sufficient profits that one could argue the entire automotive business comes for free.

HSBC is a UK listed bank with the majority of its operations based in Asia. The shares have de-rated relative to the rest of the UK banking sector due to concerns about the Asian economy. HSBC has historically traded at a premium to the rest of the sector due to its balance sheet and franchise strength and we believe these attributes will be rewarded with a higher multiple in time.

Centrica is a UK listed retail energy provider. It has had a very chequered past but a new management team are resolving the historic issues and there has been a reduction in competition in the sector which may lead to an improved operating environment. We don't think this is discounted in the valuation.

We have materially increased our position in ITV following an extremely harsh share price reaction to their full-year results. The results themselves were strong but the company announced further investments into their streaming platform which the market did not like. However, the shares are now trading on a very low valuation and the core franchise is performing better than expected.

Elsewhere, we saw the flotation and subsequent sale of the unquoted holding in Oxford Nanopore at a substantial profit. There remain nine unquoted companies in the portfolio and we continue to work hard on realising value from these.

Views from Franklin Templeton Fund Management Limited

Investment manager of the Omnis UK Smaller Companies Fund

On a sector basis, an overweight allocation to technology and a lack of exposure to energy detracted from relative returns, as did stock selection in travel and leisure. Conversely, stock selection in real estate, health care, media and financial services contributed to relative results.

At a stock level, gift-wrap maker IG Design Group, whose share price was down over 80%, was the largest detractor from relative results. The company reported further downgrades, due to a rapid increase in labour, raw materials, and logistic costs. We believe these cost headwinds will continue for many businesses throughout this year and beyond, and so sold IG.

Marketing automation business dotDigital Group was also among the most significant detractors from relative performance, with the share price down almost 66%, despite earnings being in line with expectations. The poor performance mainly reflects slower growth in the Americas, resulting from a loss of key personnel in a challenging labour market that is seeing high levels of wage inflation.

Conversely, fund administration business JTC was among the greatest contributors to relative results at the stock level. The company's share price advanced over 13% during the period as analysts upgraded their outlook for the business after an acquisition in the fourth quarter of 2021.

In terms of activity, we participated in the initial public offering (IPO) of Devolver Digital, which focuses on independent video games. The company has a very strong back catalogue of 90 games, the majority of which have been profitable, alongside an exciting pipeline of new titles. With a great reputation in the industry, the company focuses on nurturing innovation and supporting developers through a very experienced team.

We sold information technology reseller Bytes Technology Group on valuation grounds. We also sold out of shipbroker Clarkson. In our view, risks were building for the business and, out of prudence, we liquidated the position. We disposed of our holding in IG Design after the company released a January trading update indicating that profitability would be further impacted by supply chain delays and cost inflation.

Views from T. Rowe Price

Investment manager of the Omnis US Equity Leaders Fund

T.RowePrice℠

Within the portfolio, sector weighting drove relative underperformance while beneficial stock selection capped losses. Consumer discretionary was the largest detractor from relative returns where shares of Home Depot, for example, declined. Consumer staples also detracted from relative results due to an underweight allocation and shares of Olaplex Holdings finished the period lower.

Conversely, the financials sector was the largest contributor to relative performance due to stock selection. Chubb and Charles Schwab outperformed amid heightened expectations for rising interest rates. Within communication services, stock selection also boosted results; the portfolio's underweight position in Meta Platforms assisted returns as shares sold off towards the end of the period.

The health care sector is one of our largest absolute positions in the fund, as well as the largest overweight position relative to the benchmark. In the sector, we are focused on finding opportunities to take advantage of lasting trends such as managed care industry consolidation, innovations in medical equipment, and robotic technology. In therapeutics, we are focussing on select companies that have strong fundamentals and the potential to bring additional new drugs to market in areas with large, unmet clinical needs.

Information technology represents our largest absolute sector weight but is our biggest underweight position relative to the benchmark. Within the sector, we focus on innovative business models that can take advantage of transformational change. We favour companies that address large and growing markets, including electronic payment processing, public cloud computing, and consumer technology.

During the period, we took advantage of select buying opportunities as we identified high-quality companies trading at compelling valuations. We initiated positions in consumer technology giant Apple, home improvement retailer Home Depot, foodservice equipment company Middleby, and global aerospace and defence company Airbus and increased our position in discount broker Charles Schwab.

Conversely, we trimmed names in the portfolio where we did not have complete confidence in their balance sheets or where we found better risk/reward ideas. We eliminated our positions in diversified health care company Johnson & Johnson, global food and beverages manufacturer PepsiCo, insurance brokerage Marsh & McLennan, industrial gases company Linde, and pharmaceutical company Eli Lilly.

Despite high volatility, US stocks recorded modest gains during the period. The start of the period was characterised by investor optimism; despite elevated inflation and the continued spread of the Delta variant of the coronavirus, several indices reached new highs as the economy continued to recover and corporate earnings growth remained strong. However, toward the end of the calendar year, expectations that the US Federal Reserve would taper asset purchases faster than previously anticipated in preparation to increase short-term interest rates and the discovery of the Omicron variant of the coronavirus simultaneously began weighing on financial markets.

In the latter half of the period, several major indices slipped into a correction as US stocks experienced their worst quarter since the beginning of the pandemic. Inflationary pressures, which were already elevated at the start of the first quarter of 2022, were worsened by the Russian invasion of Ukraine in late February; the conflict, which led many nations to enact economic sanctions against Russia, exacerbated global supply chain issues and increased commodity prices.

Toward the end of the period, despite the ongoing conflict in Ukraine and increasing expectations for the Fed to pursue an aggressive pace of monetary tightening, equities staged a modest recovery, erasing most of the early losses.

Views from T. Rowe Price

Investment manager of the Omnis US Smaller Companies Fund

T.RowePrice℠

Stock selection in industrials and business services detracted from relative results. Gibraltar Industries is a collection of niche businesses exposed to residential construction, infrastructure, and renewable energy. The company's most recent results were pressured by weakness in the renewables segment due to supply chain issues and bottlenecks as well as higher structural steel costs. We remain confident in the management team and its ability to drive value creation via portfolio transformation and operational efficiency.

Materials hindered relative returns due to stock choices, although an overweight position partially offset those losses. Shares of Quaker Houghton, a leading process chemicals formulator, declined as rising oil prices compressed gross margins. Avery Dennison is a packaging company focused on pressure-sensitive materials and labelling. Inflation and supply chain pressures were among the headwinds that weighed on the company's most recent earnings report, which fell short of expectations and sent shares lower.

Stock picks in information technology also weighed on performance. Avalara is a company that specializes in cloud-based software that calculates customers' sales tax obligations across US states and counties as well as international markets. Shares were pressured by concerns that acquisitions would hinder organic growth. Additionally, a general software sell-off weighed on shares.

Conversely, holdings in health care contributed to performance. Shares of Medicaid managed care company Molina Healthcare rose on quarterly results reflecting broad-based strength. Growth in both its Medicaid and Medicare segments exceeded expectations. We believe the company will continue to make progress in its operational turnaround and expand its presence via niche acquisitions. Strong performance from its home health and hospice divisions boosted shares of health care services company Amedisys. We like the company's experienced management team and its ability to generate organic growth over the long term.

Consumer discretionary added value due to an underweight position and stock selection. Shares of SeaWorld Entertainment appreciated on solid results reflecting improving attendance trends and strong expense and cash management. Forward guidance highlighting the potential for significant margin expansion post-pandemic provided additional support to shares. Marriott Vacations Worldwide has demonstrated the resiliency of its business model through the pandemic. Shares were boosted by the release of pent-up leisure travel demand, despite continued headwinds from the Delta and Omicron coronavirus variants.

US equities were mixed for the period, with large-cap indices outperforming mid- and small-cap counterparts and growth stocks trailing value stocks. In the first half of the period, stocks overcame a late-November sell-off in reaction to the global spread of the Omicron variant of the coronavirus to post solid gains. Investors seemed reassured that the Omicron variant appeared to cause milder illness and seemed to have peaked rapidly in South Africa, where it was first discovered.

Equity markets pulled back sharply in the new year, however, as interest rate and inflation fears were compounded by Russia's invasion of Ukraine. Major indices suffered declines of 10% or more, but a March rally saw some recovery. Fears that the Fed was "behind the curve" and would have to act aggressively to curb inflation weighed heavily on sentiment. An easing in Omicron trends seemed to result in the economy regaining momentum, but Russia's invasion of Ukraine reversed growth and inflation expectations, with the firm sanctions on Russia that followed raising concerns about supply chains already stressed by the coronavirus.

View from FIL Pensions Management

Investment manager of the Omnis European Equity Leaders Fund

Strong stock selection in the consumer discretionary, financials and information technology sectors contributed to returns during the period and the underweight stance in industrials also added relative value. However, selected positions within utilities and communication services underperformed over the period.

Select holdings in the financials sector benefited from the outlook for higher interest rates and ended the period with gains. The position in exchange operator Deutsche Boerse was among the leading contributors to performance, with exchanges a beneficiary of rising interest rates and increased market volatility. Other financials such as Zurich Insurance also rose.

The holding in Novo Nordisk advanced after it delivered strong fourth quarter results and robust revenue and profit growth in 2021, driven by an increase in sales within its diabetes and obesity care divisions. Within chemicals, industrial gases company Linde was supported by its positive earnings outlook.

The sharp rise in energy prices as a result of the Russia-Ukraine war supported the position in TotalEnergies. Swiss food major Nestle was another notable contributor as its net profit and sales rose in 2021 as it sold shares in cosmetic company L'Oréal and increased prices amid soaring global inflation.

A lack of exposure to health care names Novartis and Bayer detracted from relative performance as investors favoured 'defensives' in view of the increased market volatility. Private equity company Partners Group was a notable detractor amid concerns over high management fees although the company reported strong FY21 results and continued to grow its assets under management.

Machinery groups Schindler and Kone were also among the key detractors. Sentiment around these escalator manufacturers fell amid demand concerns generated by the debt crisis surrounding the Chinese property developer Evergrande. We retain confidence in the positions, which in practice have little exposure to poor credit.

Over the period, we raised exposure to Assa Abloy, a global leader in security and automated doors. It is a dominant player in an industry with strong customer demand for increasingly complex products and enjoys strong pricing power from selling critical products that are a small percentage of the customer's project budget.

The exposure to Intertek, a leading Total Quality Assurance provider to industries, was also increased during the period as its growth and margins are expected to recover fully over the next 12 months, and the recent sell-off represents a good opportunity to buy what remains a good quality business. The holding in Fresenius Medical Care was closed.

Views from Barings Asset Management Limited

Investment manager of the Omnis European Equity Opportunities Fund

BARINGS

European equity markets declined over the six-month period, The asset class started the period positively, returning approximately 5% in the fourth quarter of 2021, before suffering significant selling in the immediate aftermath of Russia's invasion of Ukraine on 24th February 2022.

The invasion, and accompanying economic sanctions imposed on Russia by developed market economies, increased uncertainty in the economic growth outlook and heightened inflationary pressures, as access to Russian-produced commodities has declined, and global commodity prices have soared.

Over the period smaller and medium sized companies underperformed relative to larger peers. This had a meaningful negative impact on relative performance due to the portfolio's significant small and mid-cap exposure. Despite short-term underperformance, over the medium term we continue to believe smaller companies offer better growth potential, governance, and more unique stock picking opportunities for investors.

The portfolio's holdings in the Financials, Consumer Staples and Consumer Discretionary sectors accounted for a significant part of underperformance, whilst select holdings in the Industrials sector were also particularly weak. This reflected fears that economic growth will be impacted by rising energy costs and by a deterioration in consumer confidence as a result of the conflict in Ukraine.

At the stock level, French company GTT, which specialises in systems that transport, and store liquefied natural gas, was one of the most significant positive contributors to relative performance. The geopolitical situation is creating a focus on greater energy independence, which in turn has had a positive impact on the company's order book. In contrast, German mass media company ProSieben underperformed on fears that consumer sentiment and economic growth will be impacted by the conflict, which in turn will cause a sharp decline in linear TV advertising.

Some of the stronger performers in the investment universe over the period were in the financials sector, based on expectations that rising interest rates and a steepening yield curve would lead to an expansion of net interest margins. While we do own a number of companies in the sector, our investments are driven by company specific merits rather than a view on future central bank decisions.

We continue to favour companies that are likely to gain market share and exhibit their competitive advantages over the long term as opposed to those which might see short-term gains from supportive macroeconomic trends but carry more limited long-term potential.

Over the period we have continued to find prospective investments despite the operating environment, opportunities, and challenges businesses face. One such investment was in Dutch insurance group ASR, which should benefit over the medium term from industry consolidation, which has been accelerated in part due to greater regulatory burdens that are better managed by scale players such as ASR. The company also has an excellent solvency position, a strong record in capital generation and is a cost leader.

We also initiated a holding in Italian telecommunications towers services group INWIT as recent share price volatility created an attractive entry point for a company with compelling exposure to the structural growth themes of 5G and the digitisation of society. We also purchased shares in semiconductor equipment manufacturer Besi, a high-quality company that is a global leader in packaging and assembly equipment for the semiconductor industry. The company's focus on advanced packaging solutions means they are well placed to supply leading-edge technology to customers, whilst their efficient cost structure and scale is reflected in high gross margins. Other purchases over the period included HR consultancy Randstad and business services group Edenred.

Views from Schroder Investment Management Limited

Investment manger of the Omnis Japanese Equity Fund

Schroders

Japan's equity market rose in the early part of the period but declined significantly in the first quarter of 2022. The portfolio fell by slightly less than the benchmark over the six-month period, with small positive contributions from both stock selection and sector allocation.

After Japan's general election in October, the political focus shifted to a substantial fiscal stimulus package, details of which became clearer later in November. This included direct cash handouts to households in an effort to kick-start consumption in the first half of 2022, as the government attempts to reinforce recovery in the domestic economy.

Japan inevitably imported its first known case of Omicron in December, but overall Covid-19 infection rates remained remarkably low, as they had throughout 2021. Nevertheless, domestic sentiment continued to be affected by the potential risk from a pick-up in infections together with the broader impact on economic growth prospects.

From the start of 2022, the tone for the equity market was set by the release of the minutes from the US Federal Reserve meeting, and the associated change in expectations for US interest rates. Although this had a negative impact on sentiment in Japan, especially in the second half of January, such a move in interest rates is still very unlikely to be followed by the Bank of Japan in the foreseeable future.

The Russian invasion of the Ukraine dominated equity market behaviour from February onwards. Despite its geographic proximity, Russia is a relatively small trading partner for Japan, accounting for around 1% of exports and 2% of imports. The balance is skewed by the import of energy from Russia, especially LNG, while exports are predominantly in auto-related areas and most auto makers have already moved to suspend these links.

The yen weakened sharply against all major currencies in March, reaching a six-year low against the US dollar. Although expected interest rate differentials have clearly widened this year, the scale and timing of the yen's weakness is unusual given the currency's perceived role as a safe-haven asset at times of uncertainty. In the past two decades, investors have generally viewed yen weakness as positive for Japan since the benefits for exporters were seen to outweigh any potential inflationary impact throughout Japan's long period of deflation.

Currently, however, the impact of the yen's weakness on prices coincides with a reversal of several other factors, especially mobile telecom charges, which have been suppressing the year-on-year inflation rate in recent months. This is not yet evident in the headline numbers, with the latest available data showing the core inflation rate, excluding energy and fresh food, still running at -1% in February 2022. Looking slightly further forward, the Ukraine crisis implies energy prices could remain higher for longer than previously anticipated and we are likely to see a rise in inflation, which approaches the Bank of Japan's 2% target.

How long that level is sustained, and the ultimate peak for inflation in this cycle, is especially dependent on energy prices, but we still see enough structural reasons for Japan to avoid the kind of inflation spike seen elsewhere. Nevertheless, when looking at investment opportunities we are considering a range of potential scenarios for input prices and future wage inflation, given the difficulty some Japanese companies may have in raising final product prices.

The strongest individual stock contribution in this period came from Kureha, a chemical company with a diverse range of products. The key driver for the stock has been a specific product used in lithium-ion batteries which has seen strong growth in demand. The most significant offsetting negative impact came from Santen Pharmaceutical. The company specialises in eye-care, but is facing a more difficult short-term environment, especially in some Asian markets, with downward pressure on prices for some of its key products.

During the period we added a new position in Ricoh, as we believe the company should successfully transition towards a full IT service vendor for small and mid-sized businesses. We also added Nitto Denko to the portfolio as we see several solid growth drivers within their diversified business as well as the profitability improvements within their core industrial tapes. A new holding was also started in Yokogawa Electric, which supplies measurement and control equipment used in factory automation. The stock looks particularly undervalued against its global peers given the near-term industry dynamics and the longer-term growth potential from expanding autonomous solutions.

View from Veritas Asset Management

Investment manager of the Omnis Asia Pacific (ex-Japan) Equity Fund

Veritas
— Asset
Management

The combination of the war in Ukraine, sharply higher inflation and the lingering impact of the global pandemic made the past six months an extremely tough period for stocks in Asia. Investors continued to move away from quality and growth stocks that have done well over the past few years to chase short term momentum in financials and cyclicals such as energy and commodity stocks.

The fund had very little exposure to these areas and consequently underperformed. We have long held the view that many banks and property stocks in Asia have long-term issues because of competition and past excesses in the property sector. Lots of the past growth in Asia has been driven by excessive real estate investments and fuelled by ill-disciplined lending from banks. We believe going forward, banks and property companies face significant headwinds. We also have challenges with investing in energy and commodities. In a world moving gradually into zero emission, it is very hard to be bullish on these businesses. The future is too uncertain for them despite the acute short term supply shortage.

The fund has a thematic approach. We primarily focus on five areas of growth in Asia: aspirational spending, renewable energy, healthcare, internet and companies looking to gain efficiency through restructuring and technological upgrades. These areas are currently out of favour as investors chase momentum in the so-called 'value trade' for fear of missing out on short term performance. However, we are confident that over the longer term, the stocks we are invested in within the fund will achieve significant returns for our investors as these businesses create value when many of the so-called value stocks actually destroy value over the longer term.

We continue to hold onto and add to our positions in Electric Vehicle (EV) battery makers such as LG Chem in South Korea – it is one of the world's largest electrical vehicle battery makers and is going into joint ventures with car makers such as General Motor and Stellantis. We have also added to CSL, the world's biggest producer of blood plasma related products. It has a strong position in immunotherapy globally, helping patients with life-threatening medical conditions.

We are also very positive on the semiconductor industry. Our world is getting more connected with increasing adoption of 5G, cloud computing and IOT (internet of all things). Growth in assisted driving and autonomous driving will further increase the demand for sophisticated semiconductor chips. We have added to both Taiwan Semiconductor Manufacturing Corp and Samsung Electronics, both long-term holdings in the fund. Both companies are leaders in the semiconductor industry.

TSMC is dominant in cutting-edge technology of the most sophisticated chips for the likes of Intel and Apple using 5 to 3 nanometre technology (for reference, the diameter of a human hair is about 80,000 to 100,000 nanometres). Businesses such as these have strong entry barriers and are beneficiaries of very strong structural growth trends and we are convinced that they will outperform many Asian banks and commodity companies in the long-term as they have done in the past decades.

The Chinese stock market has had a gruelling year starting with a regulatory crackdown on the nation's biggest internet companies; trade and political tension with the US and now the Russian invasion raising the spectre of an all-out East/West confrontation. However, we believe that a lot of the risks are now factored into the stock market. The Chinese authorities have been easing monetary policy lately and have begun to take fiscal measures to support the economy.

Views from FIL Pensions Management

Investment manager of the Omnis Global Emerging Markets Equity Leaders Fund

Despite the war in Ukraine, which impacted markets globally, the portfolio's lack of Russian exposure has had a net positive relative impact on performance. The rise in commodity prices in an inflationary environment along with favourable stock selection in the materials sector contributed to relative returns. The portfolio's copper holdings First Quantum Minerals and Southern Copper were among the top contributors.

Copper will likely benefit given the accelerated move to Electric vehicle/ alternative energy in case of persistent higher oil prices. Despite the rise in crude oil prices, the lack of exposure to the energy sector contributed at a sector level, as the benchmark's top energy holdings were dominated by Russian names – not holding Gazprom, Lukoil and Novatek added notable value.

Within the consumer discretionary sector, China-based clothing manufacturer Shenzhou International Group declined as investors remained wary of near-term COVID-19 impact on its operations and the slow production capacity recovery in Vietnam. At the country level, the underweight stance to Brazil detracted from returns and the lack of exposure to Brazilian stocks Vale (miner) and Petroleo Brasileiro-Petrobras (integrated oil and gas company) hampered relative stock returns.

An increase in commodity prices and the search for value has seen investors rotate into these areas of the markets – particularly as inflationary pressures persist. The move towards Brazilian assets intensified as investors abandoned the Russian market. Elsewhere, leading diary giant China Mengniu fared poorly. Investor sentiment was hurt due to concerns over muted growth in recent months given weakness in ambient yoghurt and milk beverage sales.

During the review period, the focus remained on identifying and owning well-managed businesses with attractive return profiles and valuation that offers an adequate margin of safety on a free-cash-flow basis. We remain confident that the portfolio is well equipped to deliver attractive risk-adjusted performance for our investors and remains well positioned to navigate through a volatile market backdrop. The Fund has no exposure to Russia, Belarus, or the Ukraine.

Within IT, our largest sector overweight, we own hardware industry leaders such as TSMC, SK Hynix and Samsung Electronics with the view that we will see exponential growth in data requirements, and that these are the absolute building blocks for processing power and storage. We also maintain a position in MediaTek, a leading beneficiary of 5G. Memory component suppliers have been weaker as the market worries about the peaking of the memory cycle – we are less concerned given attractive valuations, industry consolidation and solid longer-term structural drivers.

In financials, we sold the position in Mexican exchange Grupo BMV amid lower growth and margin expectations. However, we increased the exposure in Indian lender Axis Bank for its better risk-reward characteristics. Elsewhere, we initiated a new position in India-based two-wheeler manufacturer Eicher Motors at an attractive valuation. It is a market leader in the underpenetrated premium motorcycle segment, which continues to benefit from 'premiumisation' with very low risk of electrification competition.

Views from Somerset Capital Management LLP

Investment manager of the Omnis Global Emerging Markets Equity Opportunities Fund

SOMERSET
CAPITAL MANAGEMENT LLP

Emerging Markets have experienced a difficult six months. The resurgence of COVID-19 in China and associated restrictions have negatively affected Chinese economic growth and asset prices. At the time of writing, Shanghai has just been placed into full lockdown. Russia's invasion of Ukraine put further upwards pressure on commodity prices at the start of 2022 and has exacerbated inflationary pressures in the global economy.

Chinese consumer facing companies – including our holdings Wuliangye, Yum China and Zhejiang Supor – have been hurt by rising input costs combined with weak demand, constraining profit growth. The Fund's largest Chinese holding is China Overseas Property Holdings ('COPH'), the property management company. There is limited impact on the company's business from COVID-related restrictions and the stock has performed well over the period. It benefits from recurring revenue streams from its management contracts and a low propensity to switch on the part of its customers.

Its parent, a financially strong Chinese developer, provides a steady stream of new business, steadily adding to the recurring revenue stream. The business is capital-light, high-return and highly cash generative. COPH has been essentially unaffected by the financial difficulties of some over-leveraged players in the development sector and valuations remain reasonable.

The two large e-commerce businesses in the portfolio, SEA Ltd and Mercadolibre, both performed poorly. The former is focused on South-East Asia and the latter on Latin America. We believe they are the best-in-class operators in their respective regions. However, competition is rising, while the companies' growth rates are inevitably slowing after the supernormal growth that followed the advent of COVID-19 last year. At the same time, investors' increased focus on the prospect of rising interest rates in the United States has reduced tolerance for loss-making companies (such as SEA Ltd and Mercadolibre) that are investing heavily today to produce cash flows in the future. We exited the positions early this year but will continue to monitor the companies.

After its strong performance in 2020 we have reduced portfolio exposure to the semiconductor industry, selling several of the strongest performing stocks (eMemory, Aspeed, Parade) which had become expensively valued. We retain diversified exposure to the sector, including the leading logic (TSMC, Samsung) and memory (Samsung, SK Hynix) chip manufacturers and several providers of niche high-end equipment and technology to the industry (Koh Young, Leeno, Park Systems). While the industry is subject to supply and demand driven cycles in the shorter term, over the longer-term semiconductor demand should continue to grow above the rate of global GDP, driven by digitalisation and artificial intelligence, among other things.

Elsewhere, our eastern European holdings (Wizz Air, the Hungarian low-cost airline, and Dino, the Polish proximity supermarket) faced selling pressure due to anxiety about regional spill-over effects from the war in Ukraine. Both are strong businesses with leading market positions. We do not expect any material long-term impact on their profitability from the conflict. Wizz Air does now have to deal with higher jet fuel prices (though its competitors do too) and has had to reallocate some capacity away from Russia and Ukraine, but management is confident these issues can be worked through.

Rising commodity prices have acted as a tonic for commodity producing nations including South Africa and Brazil. Hapvida, the integrated healthcare company in Brazil, performed strongly after the approval of its merger with a large rival and the announcement of synergy targets. The Fund's other holdings in Brazil and South Africa also contributed positively.

Rising inflation generally acts as a margin tailwind for financial companies. We initiated a position in KB Financial, a Korean bank with a cheap valuation, conservatively managed asset quality and an improved focus on shareholder returns. Should interest rates in Korea increase, its profitability should benefit.

Views from Western Asset Management

Investment manager of the Omnis Global Bond Fund

Global government bonds traded within a wide range during the last quarter of 2021, as the emergence of the new Omicron Covid variant caused significant intra-quarter volatility. The quarter saw a number of key developed market (DM) central banks make significant strides in monetary policy tightening as inflation across the US, Europe and the UK surpassed expectations.

In the fund the US yield curve flattening position was reduced while the underweight to US Mortgage Backed Securities (MBS) was increased. Emerging market central banks continued their policy hiking cycles amid growing inflationary pressures. Local currency emerging market (EM) government bonds generally outperformed their DM counterparts. The fund rotated from hard currency EM bonds into investment grade corporates and overall reduced the EM currency exposure versus the US Dollar. Global government bond yields were very volatile during Q1 but ended the period higher. The fund initiated overweight positions in Australian and Canadian government bonds.

The Russian invasion of Ukraine in February sent shockwaves through financial markets, prompting a flight to safety with risk assets selling off and government bonds yields falling. A number of United Nations (UN) countries announced a broad range of sanctions limiting Russian activities overseas, including Russia's participation in global financial markets.

Moody's, S&P and Fitch all downgraded local Russian sovereign debt to junk and Russia was removed from global bond indices. On 15 February the Russian holdings in the fund were sold. Finally, the fund switched from underweight to overweight in overall portfolio duration, adding to core European and UK duration.

Across the period we transitioned to align macro positions, repositioned the Investment Grade (IG) corporates, reduced MBS, added emerging markets and high yield and reduced the overall number of holdings.

Views from FIL Pensions Management

Investment manger of the Omnis Strategic Bond Fund

The portfolio posted negative returns, underperforming inflation linked bonds but broadly outperforming government, investment grade, and high yield bonds.

Credit exposure added value, primarily due to coupon income. Credit spreads widened amid rising volatility related to China's property sector, supply chain constraints, an increase in input prices, the emergence of the more virulent Omicron variant of COVID-19, geopolitical tensions between Russia and Ukraine, and worries around the potential impact of monetary policy tightening.

Concerns were further exacerbated as China's home sales slump deepened in March, keeping the pressure on cash-strapped developers even as policy makers vowed to support the property market. The exposure to Chinese property names such as Shimao Group Holdings, Red Sun Properties, and Modern Land China were among the top detractors from performance.

The exposure to US dollar, euro and sterling interest rate risk weighed on returns as sovereign bond yields, including US Treasury yields, German bund yields, and UK government bond yields (Gilts) rose across the curve. However, losses were partially offset by the US dollar, euro, and sterling duration positions at the front end of the yield curve. The small exposure to Canadian dollar duration also enhanced gains.

Views from Threadneedle Asset Management Limited

Investment manger of the Omnis UK Gilt Fund

UK government bonds (or gilts) had a turbulent six months, with yields (which move inversely to price) rising sharply. At the start of the period, the fund was 0.55 years overweight duration relative to the benchmark.

In the first half of October, we increased the fund's long duration position (which measures the sensitivity of bonds to changes in interest rates) versus the benchmark, as the yields on offer for certain bonds traded around year-to-date highs. Later in the month, we trimmed back some duration and participated in the UK's second 'green gilt' issue, which matures in 2053.

At the start of November, the fund reduced exposure to ultralong bonds. After the Bank of England (BoE) opted against a rate hike, there was an increase in the yield differential between longer-dated bonds versus shorter-dated bonds. Against this backdrop, we sold bonds maturing in 2031 and purchased issues with longer maturities.

Activity in December was focused on reducing duration through sales and switches between bonds with different maturities. Overall, the fund outperformed in the fourth quarter of 2021, due to curve positioning and the tactical trading of duration.

The fund underperformed in the first quarter of 2022, as markets factored in increasingly aggressive interest-rate hikes and the removal of monetary stimulus in response to soaring inflation. After briefly benefiting from a flight to safety in the immediate aftermath of Russia's invasion of Ukraine, gilts continued to sell off as the conflict and the resulting surge in commodity prices put even more upward pressure on inflation expectations. Our modest long duration position versus the benchmark was disadvantageous as yields rose sharply across the curve.

January was a quiet month for activity. We added to the overweight in 15–25-year gilts, while trimming overweight positions in both shorter- and longer-dated gilts.

In early February, we switched some exposure from 10-year gilts into their five-year counterparts as the yield differential between these bonds reduced. Around mid-month, the fund sold gilts maturing in 2061 and bought some maturing in 2039 as the yield available on shorter-dated bonds increased versus longer-dated bonds. As this trend in yields started to reverse into month end, we sold bonds maturing in 2046 and reinvested the proceeds into shorter-dated issues.

During March, the portfolio had a sizeable underweight in ultralong versus long-dated gilts as the yield on offer was greater in the latter. Over the month, as the spread moderated, this trade was reduced to take profits. Meanwhile, we continued to add duration in shorter-dated gilts, as we did not think the BoE would deliver as many rate hikes as the market had priced in.

Views from Threadneedle Asset Management Limited

Investment manager of the Omnis Sterling Corporate Bond Fund

As measured by the fund's illustrative index, sterling investment-grade (IG) corporate bonds suffered losses in total-return terms over the six months in review. A sharp rise in underlying UK government bond (or 'gilt') yields was compounded by a significant widening in credit spreads (the difference in yields offered by corporate bonds versus those available on similarly dated 'risk free' government bonds). The main determinant of performance relative to the index was credit selection, which is as we would expect given our bottom-up investment strategy, though other factors had an impact, as outlined below.

In the fourth quarter (Q4) of 2021, credit spreads widened but this was offset by strength in longer-dated gilts. While yields on shorter-dated gilts rose (bond prices fall when yields rise), those further out on the curve fell along with longer-term growth and inflation expectations as major central banks turned more hawkish. The fund is underweight at the short end of the curve and overweight at the long end, so these developments helped relative performance.

With regards to credit strategies, however, the fund has long had a slight overweight in credit risk, or 'beta', including off-benchmark exposure to high-yield bonds, which means it is somewhat more sensitive than the market as a whole to changes in spreads. This was marginally disadvantageous as concerns about the emergence of the Omicron coronavirus variant in late November and surging European wholesale gas prices pushed spreads wider.

Volatility picked up markedly in Q1 of 2022. Stocks, corporate bonds, and government bonds alike weakened as markets factored in increasingly aggressive interest-rate hikes and the removal of monetary stimulus in response to inflation that continued to soar. From mid-February until the second half of March, stocks and corporate spreads came under additional pressure as Russia's brutal invasion of Ukraine dampened investors' appetite for risk.

Meanwhile, after briefly benefiting from a flight to safety, gilts continued to sell off as the Ukraine crisis put still more upward pressure on inflation expectations. Although the portfolio only had a small overweight in duration (interest-rate sensitivity), the extent of the rise in gilt yields meant this had a negative impact on relative performance. With spreads widening around three times as much in Q1 2022 as in Q4 2021, the modest beta overweight also weighed more heavily on relative returns. More positively, the fund saw a larger boost from favourable credit selection during this period of volatility.

With regards to specific trades, we took part in a wide range of new issues over the period. The largest concentrations of these were in banks (such as Nationwide, BFCM, BNP Paribas, NatWest, BPCE, Credit Suisse, Co-op Bank and Commerzbank) and real-estate companies (including P3, Places for People, Saltaire (the funding vehicle for the government's Affordable Homes Guarantee Scheme), Accent, Peabody, Realty Income and Prologis). Others from outside these sectors included new deals from Bupa, Thermo Fisher Scientific, Broadcom, GSK, Autostrade per l'Italia and Magallanes, the AT&T subsidiary created for the spin-off of WarnerMedia prior to its merger with Discovery.

Trades in the secondary market included staring new positions in pharmaceutical giant Pfizer and real-estate group Annington, while increasing issuers including Barclays, HSBC, Clarion (the UK's largest housing association), Western Power Distribution and US bank Well Fargo.

View from Fulcrum Asset Management

Investment manager of the Omnis Diversified Returns Fund

FULCRUM

The impact of supply bottlenecks, high inflation and elevated energy prices continued to dominate markets for much of the first two months of the final quarter of 2021, with most risk assets trending higher. Towards the end of November, however, the emergence of a new Covid-19 variant, Omicron, sparked a risk-off mood across equities, commodities, and credit markets.

Concurrently, US Federal Reserve Chair Powell's acknowledgement that inflation might not be as "transitory" as initially expected led markets to price in faster than previously expected rises in interest rates. The US yield curve flattened with short-term interest rates rising and long-term rates falling. Elsewhere, the US dollar rallied strongly, and oil fell, driven by renewed concerns over widespread restrictions on mobility.

Towards the middle of December, markets looked beyond the Federal Reserve's hawkish pivot, the more transmissible – but likely more benign – Omicron variant, and a paring back of US fiscal support after the Build Back Better program failed to pass through Congress.

Overall, global equity markets finished 2021 higher. Yield curves around the major developed countries flattened as markets brought forward rate hikes and the US dollar strengthened. Elsewhere, oil recovered strongly to finish the final quarter broadly flat, while precious metals posted positive returns, and inflation-adjusted nominal yields were down on the quarter.

In the Fund, directional strategies were the main contributors to returns in Q4 2021, coming from our North America and Climate Change related exposure as equities had a strong quarter. Also, thematic equities posted positive returns, with gains from some of our energy and technology disruption themes.

Fixed income was marginally profitable over the quarter with significant regional dispersion, as gains from European, Central and Eastern Europe, Middle East and Africa and Chinese duration positions offset our losses from short UK duration exposure. Commodities detracted slightly due to our short positioning into precious metals.

Our equity macro strategy detracted over the quarter, while our volatility and dynamic convexity strategies both contributed positively. In the fourth quarter of 2021, our negative view on the UK, based on a stagflationary environment and potential tough Brexit repercussions, was a significant detractor from currency performance and we closed our short UK pound position as the situation evolved. Our negative exposure to the Chinese renminbi, which we expected would hedge against a fall in economic activity in China, also contributed negatively as the market looked past the slowdown in Chinese growth.

The first quarter of 2022 established new records for major asset classes, catching investors with traditional portfolios off guard following a very strong 2021. Q1 2022 was the second worst start to a year for US stocks since 2008, whilst global bonds provided no cushion, experiencing their worst drawdown on record as inflation accelerated and the reversal gathered momentum. Meanwhile, commodities posted their best start to a year.

Financial markets grappled with several key issues. Russia invaded Ukraine on the 24th of February, sending significant effects across financial markets, especially within commodities, and further fuelling inflation pressures that had been building since late 2020. Central banks tore up their transitory inflation rationale and decided to stand firm behind their stable price level mandates.

China reiterated its willingness to crack down on any Covid outbreak, thereby dismissing speculation around living with Covid, until any effective vaccine is administered to its population.

Against this backdrop, the US yield curve flattened further with short-term interest rates rising much faster than long-term interest rates. European equity markets were the most impacted during the quarter given their close proximity to the situation in Ukraine: heavy dependence on Russian commodities, war breaking out on the borders of Europe and greater likelihood of assistance to Ukraine.

In the Fund, our short rates positions in the US and Europe contributed strongly within our fixed income strategy due to expectations of more hawkish monetary policy in these regions. Within currencies, our view on the Brazilian Real versus the Mexican Peso was the main driver of currency returns. Our negative view of inflation also led us to build positions with attractive payoffs in our dynamic convexity strategy, which performed strongly during the quarter.

In commodities our views on inflation together with our long-held thesis that there has been significant underinvestment in the commodity complex contributed to returns. Thematic equities also had a good quarter, led by gains from our climate change and global energy themes. Contribution from directional strategies was negative as we saw underperformance from traditional asset classes and equities sold off in the first two month of 2022 before rebounding in March.

Views from Hermes Investment Management Limited

Investment manager of the Omnis Absolute Return Bond Fund

Over the fourth quarter we saw U.S. Treasury yields rising in October as markets priced in the increasing likelihood of a rate hiking cycle particularly as high inflation was looking less transitory. High Yield was down in October while investment grade corporates were relatively flat against a backdrop of calm markets and low volatility. In November, markets were worried by a new Covid variant which saw global credit markets come under pressure with high yield seeing its worst month since 2020 before recovering strongly in December.

Towards the end of 2021, we reduced duration (sensitivity of price to changes in interest rates), increased exposure to European credit names given a supportive European Central Bank, reduced cyclicality (sectors that are more sensitive to business cycles) of the portfolio and focussed more on intermediate maturities ahead of a US rate hiking cycle.

Although we remained cautious overall, we improved our view on risk within our December Credit Strategy Meeting. In line with this, we added to parts of the market we saw offering attractive value such as; i) financials, ii) selected parts of Emerging Markets, including adding a conservative exposure to China, taking advantage of the heavily depressed valuations there, and iii) Structured Credit in line with our view on the attractive relative value of the asset class.

As part of the portfolio protection, within the hedge overlay we reduced index protection in the US, whilst also rolling our credit options further into 2022. Mindful of a potential increase in rates volatility we continued to look for opportunities to reduce longer dated exposure and maintain low duration in the fund. We also added to our interest rates hedge in Europe.

Going into 2022, in January, we modestly increased overall portfolio duration as valuations looked more attractive. We believed the market was underestimating the impact to global growth from a slowing China and the potential that the US Federal Reserve may not be able to hike interest rates as much as expected. While we continued to focus primarily on intermediate maturities of around three to seven years, we also started to look at opportunities in longer dated bonds as credit spreads (yield differential between a treasury and corporate bond of the same maturity) widened during the month. For instance, we progressively switched from the Netflix 2025 bond to the 2030 bond.

We also increased overall exposure to Media, Utilities and to Real Estate primarily via the higher quality end of Chinese property developers such as Logan Group . We selectively increased exposure to U.S. dollar denominated instruments where the relative value was more favourable. For example, within Capital Goods, we switched from the 2027 EUR bond to the 2030 USD bond of packaging company Ball Corp. for additional yield pick-up and spread. Exposure to Energy remained very limited as we still believed the sector was overpriced despite the sell-off. We continued to have a higher quality bias and very light exposure to issuers rated B or below.

Financial markets were shaken in February by Russia's invasion of Ukraine, which resulted in a spike in volatility across multiple asset classes. The invasion shocked European markets and sent commodities such as oil soaring to record levels and triggered severe sanctions from countries around the world including freezing assets of named individuals and certain banks. As a result, the portfolio was down in February with Banking and Financial Services key detractors given our high exposure to this sector. Our more defensive bias with significant exposure to Capital Goods and Telecoms also detracted. Credit default swaps on European credit were positive for performance.

Towards the back end of February and throughout March, geopolitical turmoil and the prospect of more aggressive central bank hikes triggered a risk-off environment, with all segments of global credit in negative territory.

Views from AXA Investment Managers

Investment manager of the Omnis Short-Dated Bond Fund

Due to expensive valuations, persistently high inflation, a hawkish US Federal Reserve (Fed), and Omicron-related uncertainties, we continued to de-risk the portfolio in the fourth quarter of 2021. As such, we further increased our overall exposure to sovereign debt as we switched out of nominal bonds into inflation-linked bonds, almost doubling the exposure to the latter to benefit from supportive inflation indexation over the next couple of months. Our exposure was made of US, German, and French short-dated, inflation-linked bonds.

Meanwhile, we continued to reduce our exposure to high-yield and emerging markets by mainly reducing US high-yield due to expensive valuations and less supportive technicals as the Fed was expected to start tapering quantitative easing and subsequently raise interest rates. Our exposure to investment grade markets was broadly stable during the fourth quarter with the portfolio ending the quarter significantly underweight risk versus its neutral allocation. This activity led the average portfolio credit rating go up to A- from BBB+.

At a sector level, we also continued to de-risk, reducing our exposure to cyclical names while we also reduced the allocation of bonds maturing between three and five years in order to further shorten the spread duration of the portfolio. The duration remained close to one year during the fourth quarter as we feared that an increasingly hawkish Fed and persistent inflationary pressures would lead to higher yields.

The de-risking undertaken since March 2021 and our very low duration at only one year put us in a great position to not only limit the negative impact from the broad market weakness experienced in the first quarter of 2022, but also to re-risk at much more attractive valuations as yields rose and credit spreads widened. As such, our overall sovereign exposure fell by a third as we reduced our allocation to nominal sovereign debt and took profit on our French inflation-linked bonds in March following their strong performance.

Meanwhile, we increased our exposure to investment grade markets by markedly focusing particularly on the sterling credit market which came under pressure due to the surprise announcement from the Bank of England that it would actively sell its portfolio of corporate bonds. We also increased our exposure to high-yield and emerging markets focusing particularly on European high-yield which significantly underperformed due its proximity to the war in Ukraine. Most of the increase was done through the secondary market as issuance remained very scarce from February onwards.

The portfolio ended the quarter slightly overweight risk versus its neutral allocation as being overweight cash and sovereign debt ,underweight investment grade credit and overweight high-yield and emerging markets. This activity led the average portfolio credit rating to go down BBB from A-. At a sector level, we increased our exposure to financials as they should directly benefit from higher yields and increased our exposure to defensive and cyclical respectively.

We increased the allocation of bonds maturing between three and five years to lengthen the spread duration of the portfolio. The duration was actively managed to successfully benefit from the high level of interest rates volatility experienced.

Find out more

For more information please get in touch with your financial adviser, or visit the strategy funds page on the Omnis website.

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