

# Thornburg Multisector Opportunistic Strategy

Portfolio Manager Commentary

30 June 2022



## Market Review

Weighed down by a litany of concerns, the fixed income markets experienced one of the worst quarters on record. The list of investor worries going into the second half of the year is lengthy: rampant inflation, hawkish global central bank policy, rate hikes, quantitative tightening, the war in Ukraine, energy costs, slowing economic growth and a potentially looming recession. Yields across nearly every fixed income asset class were up substantially during the quarter as the U.S. Federal Reserve set the pace for other global central banks by hiking the Fed Funds rate in increasing increments in March (+25bps), May (+50bps) and June (+75bps). Spurred by monthly CPI data in May that was worse than expected, June marked the first 75bps hike since 1994 and served as a confirmation that inflation has become entrenched in the U.S. The same week in June the Swiss National Bank hiked rates (+50bps) for the first time in 15 years, as did Brazil's central bank (+50bps), and the Bank of England (+50bps). The data dependent decision-making process at global central banks, akin to driving by looking in the rearview mirror, has left many behind the curve on interest rate policy which has contributed to inflation rising to 40-year highs. As central banks now play catch-up, investors are faced with the likelihood of a not-so-soft landing, and the realization has set in that the recession many feared at the end of 2019 was not avoided by massive fiscal and monetary stimulus, but instead was only delayed.

Global rate hikes left fixed income investors with no place to hide as bonds sold off along with what felt like every other financial asset during the quarter. Longer duration bonds bore the brunt of the selloff with some debt markets down double digits on the quarter and many down over 20% on a year-to-date basis. The yield on the 10-year U.S. Treasury, which began the quarter at 2.35%, rose to 3.48%, which marked the highest level since February 2011, but managed to pare its

We are taking advantage of volatility to pursue attractive opportunities within fixed income.

## Portfolio Managers

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Supported by the entire Thornburg investment team

## Average Annual Returns (% , as of 30 Jun 2022)

	QTD	YTD	1-YR	3-YR	5-YR	10-YR
<b>Multisector Opportunistic Composite (Net)</b>	-3.77	-6.93	-6.13	1.96	2.82	4.19
<b>Multisector Opportunistic Composite (Gross)</b>	-3.62	-6.65	-5.57	2.57	3.44	4.85
<b>BBG US Universal TR Value Index</b>	-5.13	-10.93	-10.89	-0.94	0.94	1.83

## Annual Return Performance Summary

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Multisector Opportunistic Composite (Net)</b>	13.04	6.49	3.66	-1.77	8.25	6.60	0.77	7.92	8.25	2.77
<b>Multisector Opportunistic Composite (Gross)</b>	13.88	7.28	4.34	-1.15	8.94	7.27	1.38	8.56	8.90	3.39
<b>BBG US Universal TR Value Index</b>	5.54	-1.35	5.56	0.43	3.91	4.09	-0.25	9.29	7.58	-1.10

**In US\$ terms. Returns may increase or decrease as a result of currency fluctuations.** Periods less than one year are not annualized.

Performance data for the Multisector Opportunistic Strategy is from the Multisector Opportunistic Composite, inception date of 1 January 2008. The Multisector Opportunistic Composite includes all discretionary accounts invested in the Multisector Opportunistic Strategy. Returns are calculated using a time-weighted and asset-weighted calculation. Returns reflect the reinvestment of income and capital gains. Periods less than one year are not annualized. Individual account performance will vary. The performance data quoted represents past performance; it does not guarantee future results. Gross of fee returns are net of transaction costs. Net of fee returns are net of transaction costs and investment advisory fees. For periods prior to 2011, net returns for some accounts in the composite also reflect the deduction of administrative expenses. Thornburg Investment Management Inc.'s fee schedule is detailed in Part 2A of its ADV brochure. Performance results of the firm's clients will be reduced by the firm's management fees. For example, an account with a compounded annual total return of 10% would have increased by 159% over ten years. Assuming an annual management fee of 0.75%, this increase would be 142%.

losses in the final weeks of June to finish at 3.01%. Global sovereign debt broadly experienced a similar fate as yields on 10-year government debt rose by as much as 120bps in Brazil or as modestly as 7bps in Japan. Rates hikes also took their toll on investment-grade corporates and securitized debt, which were both down substantially for the quarter and for the year. Credit sectors such as U.S. and global high yield corporates also had to contend with recession concerns, igniting a flight to quality that led credit spreads to widen by a couple of hundred basis points during the quarter thus, further compounding losses created by rate movements. The waning weeks of the quarter were surprisingly unlike the previous two months as yields fell following the Fed's June rate hike. Restored credibility in the Fed's willingness and ability to fight inflation, coupled with a looming economic slowdown, led investors to reignite a bid for Treasuries given the ability to purchase bonds at multi-year high yield levels.

### Second-Quarter 2022 Performance Highlights

- The Thornburg Multisector Opportunistic Strategy composite achieved a return of -3.77% during the second quarter, outperforming the Bloomberg U.S. Universal Index, which returned -5.13%.
- The strategy's structural short duration position versus the index was a large contributor to relative performance. The 5-year U.S. Treasury yield moved higher by 58 bps to end the quarter at 3.04%, while the 10-year Treasury yield ended the period 68 bps higher at 3.01%. Curve positioning was an additional contributor given the strategy's relative shorter maturity profile. As referenced above, rates on the front end of the curve rose less than its longer maturity counterparts.
- The strategy's allocation to high yield detracted given the sector's material spread widening, with spreads (as measured by the Bloomberg Corporate High Yield Index) moving from 325 bps to 569 bps; however, the selection effect due to our high quality bias was broadly beneficial. Meanwhile, the strategy's allocation to collateralized mortgage obligations was positive, given still strong cashflow and robust housing fundamentals. Meanwhile, exposure to asset-backed securities detracted in sympathy with other risk assets. A steady supply of deals coming to market ensured that technicals remained weak in asset-backed space during the 2nd quarter. Finally, investment grade corporates detracted in sympathy with other risk assets. During the quarter, the Bloomberg Investment Grade Corporate Index widened from 116 bps to 155 bps.

### Current Positioning and Outlook

With central banks in full inflation fighting mode, the chances of a recession have risen rapidly, with the question becoming not if a recession will occur, but potentially how deep it might be. Central banks have a mixed record at best with soft landings, and the Fed is reluctant to admit that some sort of demand contraction is needed to soften inflation. Given this backdrop, portfolio risk continues to be defensively positioned. We incrementally added duration as rates have risen, believing Treasury yields have reached a level somewhat close to fair value, though tail risks remain elevated on both sides. A Fed unable to control inflation and inflation expectations is a recipe for rapidly rising rates. On the flip side, recession fears may well reignite an interest rate rally as investors once again look to Treasuries as a safe haven in times of stress.

Securitized fixed income remains the best relative value proposition in the portfolio. We are constructive on spread levels and favor a bias toward prime consumer issuance. That said, we believe the portfolio has an appropriate level of securitized risk, mindful that spreads could widen further in a risk-off environment. Though recession and inflation fears will remain an overhang, the consumer is broadly coming into the second half of the year in a position of strength. Delinquencies across prime consumer sectors are modestly higher than in 2020-2021, but remain low overall, and in many cases, still below pre-COVID levels. We continue to be cautious on the subprime consumer, given the challenges this cohort could experience should the economy drastically weaken. Within the residential mortgage space, the headwind of rising mortgage rates is being offset by still favorable supply/demand dynamics. While we expect housing market strength to wane, bondholders have plenty of built in protection from lower LTVs and existing loans underwritten with strong lending standards.

Within U.S. corporates, valuations have improved to a point that, as of quarter-end, spreads are clearly above long-term historical averages. While this makes the opportunity set within corporates more interesting, we remain fairly cautious given the weakening macro backdrop and input cost inflation. We have a bias toward names with less cyclicality and more attractive valuations versus recent history. We are cautious on bank loans both on relative value versus high yield as well as a broadly asymmetric risk/return tradeoff. In emerging markets, weakness persists in sympathy with broader risky assets and the weak

# THORNBURG MULTISECTOR OPPORTUNISTIC STRATEGY

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growth/high inflation narrative. We believe this environment has created security-level mispricing for which we will look to exploit. The timing, however, will be based on evolving domestic and global trends. We continue to look for opportunities in areas with high real rates, advanced policy cycles, and improving domestic demand.

### Important Information

*The performance data quoted represents past performance; it does not guarantee future results.*

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Holdings may change daily and may vary among accounts.

U.S. Treasury securities, such as bills, notes and bonds, are negotiable debt obligations of the U.S. government. These debt obligations are backed by the "full faith and credit" of the government and issued at various schedules and maturities. Income from Treasury securities is exempt from state and local, but not federal, taxes.

A bond credit rating assesses the financial ability of a debt issuer to make timely payments of principal and interest. Ratings of AAA (the highest), AA, A, and BBB are investment-grade quality. Ratings of BB, B, CCC, CC, C and D (the lowest) are considered below investment grade, speculative grade, or junk bonds. Investments in mortgage-backed securities (MBS) may bear additional risk.

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Asset-backed Security (ABS) – A security whose value and income payments are derived from and collateralized (or "backed") by a specified pool of underlying assets. The pool of assets is typically a group of small and illiquid assets that are unable to be sold individually. Pooling the assets into financial instruments allows them to be sold to general investors, a process called securitization, and allows the risk of investing in the underlying assets to be diversified because each security will represent a fraction of the total value of the diverse pool of underlying assets.

Basis Point (bp) – A unit equal to 1/100th of 1%. 1% = 100 basis points (bps).

Credit Spread/Quality Spread – The difference between the yields of securities with different credit qualities.

Duration – A bond's sensitivity to interest rates. Bonds with longer durations experience greater price volatility than bonds with shorter durations.

Yield Curve - A line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates.

Yield Spread - The difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another.

Consumer Price Index (CPI) - Index that measures prices of a fixed basket of goods bought by a typical consumer, including food, transportation, shelter, utilities, clothing, medical care, entertainment and other items. The CPI, published by the Bureau of Labor Statistics in the Department of Labor, is based at 100 in 1982 and is released monthly. It is widely used as a cost-of-living benchmark to adjust Social Security payments and other payment schedules, union contracts and tax brackets. Also known as the cost-of-living index.

The Bloomberg U.S. Universal Index measures the performance of U.S. dollar-denominated taxable bonds that are rated either investment-grade or high yield. The index includes U.S. Treasury bonds, investment-grade and high yield U.S. corporate bonds, mortgage-backed securities, and Eurodollar bonds.

The Blended Index is composed of 80% Bloomberg Barclays U.S. Aggregate Bond Index and 20% MSCI World Index.

The Bloomberg Global High Yield Total Return USD Index is a multi-currency measure of the global high yield debt market. The index represents the union of the U.S. High Yield, the Pan-European High Yield, and Emerging Markets Hard Currency High Yield Indices.

The Bloomberg U.S. Corporate Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility, and financial issuers that meet specified maturity, liquidity, and quality requirements.

The Bloomberg U.S. Universal Total Return Index Value Unhedged represents the union of the U.S. Aggregate Index, U.S. Corporate High-Yield, Investment Grade 144A Index, Eurodollar Index, U.S. Emerging Markets Index, and the non-ERISA eligible portion of the CMBS Index. The index covers USD denominated, taxable bonds that are rated either investment-grade or below investment-grade.

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