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WELLINGTON MANAGEMENT®

20 March 2020

DESJARDINS GLOBAL BALANCED STRATEGIC INCOME FUND: MARCH MID-MONTH UPDATE

Any views expressed herein are those of the investment management team and based on available information through the date of this memo, and are subject to change without notice.

COVID-19 MARKET PERSPECTIVE

The coronavirus outbreak has escalated during the recent period with its spread into Europe and the United States. We view this as a notable progression, as some of the cases have been deemed secondary and tertiary and cannot be traced back to their origin. The ability to accurately assess the magnitude of the epidemic has been difficult, as coronavirus has been shown to be infectious even before any symptoms emerge.

Although the outlook for global economic activity and financial markets has undoubtedly worsened, the range of potential outcomes stemming from ongoing coronavirus crisis remains quite wide. The limited information that is available suggests that the current crisis could be protracted and therefore have a profound impact on economic activity given the potential for a global demand pullback and sustained disruptions to supply chains. Although the monetary and fiscal response globally has already been substantial, central bank officials have cast doubt on the potential efficacy of further monetary policy measures; rate cuts in isolation could have a limited ability to remedy a growth shock stemming from a health emergency.

Our belief is that COVID-19 has exposed several "fault" lines across global markets. Market liquidity has become increasingly challenging post the reforms as a result of the Global Financial Crisis; we have seen that during times of stress market liquidity tends to evaporate. The oil “truce” has also not held, and Russia has decided to part ways with OPEC. Social cohesion is needed; shutdowns are more likely to work in countries with high social cohesion (e.g. China, South Korea, Japan). From a fiscal perspective, recent events have shown that the EU is not a fiscal union as countries hit hardest by the virus (Spain, Italy) cannot afford large fiscal programs whilst fiscal and health policy responses are surprisingly slow in many countries (such as the US and the UK). Central banks are starting to run out of options. Finally, but most importantly, there is significantly more debt in the financial system so a global recession could lead to devastating wave of defaults.

PORTFOLIO PERFORMANCE (1ST MARCH 2020 -13TH MARCH 2020)

In this environment, the Global Balanced Strategic Income Portfolio produced negative absolute returns (-6.2% gross) but outperformed the blended benchmark (-6.8%). Within equity, global income low volatility was detractive driven by the shock of escalated coronavirus driven economic risks. Energy equities also detracted from the portfolio, against a backdrop of a Russia-Saudi Arabia oil price war. These losses were marginally offset by contributions from Chinese equities, as Chinese equity markets were supported by a combination of improvement in economic activity indicators and signs of stabilization in coronavirus infection rates locally. Within fixed income, our core allocations to Securitized Credit (17% of the portfolio) and US Investment Grade Credit (25% of the portfolio) were additive to performance over the period.

PORTFOLIO IMPLICATIONS

From a portfolio perspective, we remain underweight equities vs fixed income but have started to sell higher quality bonds and starting to increase our weights in riskier assets such as dividend stocks and credit.

Looking at fixed income markets we have seen US Treasury yields reach all-time lows amid very high volatility, with the 10-year yield declining over 50bps since the beginning of February and credit spreads have widened. In response, we have reduced exposure to Mortgage-backed securities and increased our holdings in cash.

From an equity perspective, at the beginning of March we removed our Chinese equity hedge on the view that we are past peak market and that the Chinese government support measures are likely calm markets. Our position in Chinese equities has contributed positively to portfolio performance month-to-date. However, we continue to monitor this closely and are mindful of the risk that we see a second infection wave. We have marginally increased our investments in our global low volatility income equity strategy, based on our belief that the valuations opportunity in stock markets is beginning to look more attractive relative to bonds.

Looking ahead, we believe equity and fixed income volatility is likely to remain very high as the market will be sensitive to incoming data and further government efforts to contain the epidemic. The biggest downside market risk we see at present is a potential sharp contraction in the consumer spending in the developed markets and a second wave of infection globally which could cause further significant corrections in risk assets. A positive upside scenario could unfold if the virus proves to be highly seasonal and/or the mortality rates starting dropping towards the level of similar diseases (e.g. influenza). If that were to be correct we believe the significant fiscal and monetary stimulus provided could result in extreme re-pricing of risky assets. However, at this point we cannot say with confidence which one of these scenarios is more likely and thus, our overall levels of risk remains low-to-moderate. Our base case is a very sharp fall in 2Q20 GDP growth of between 15-25% saar in most developed countries. Overall fiscal stimulus is likely to provide a 3-4% boost and lower oil prices and low interest rate provide an additional cushion but are insufficient to prevent a global recession.

To summarize, we remain cautious as we wait to see the full extent of the impact. Even though the Coronavirus impact seems to be under control in China, it is now spreading globally and other countries are unlikely to implement similar containment strategies to those implemented in China. Before the COVID-19 outbreak, there were signs of a potential European economic recovery which, in our view, now looks far more tenuous.

We recognize the situation is very fluid and our opinions can and should change as facts do. We will endeavor to update you when we have something material to share about our outlook, positioning and/or research agenda.
In terms of medium-to-longer term views the equity risk premium, value stocks in particular, is beginning to look very attractive and as consumer activity is likely to pick up again by end of April/early May we are likely to add to equity positions in the GBSI portfolio.