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Income Fund Ltd — US Dollar Class

Quarterly Commentary

Duration positioning within the Fund remains defensive as upcoming headwinds should ensure that the most likely outcome is for higher government bond yields. The US Federal Reserve appear committed to their tightening path and markets now expect another 0.25% rise in interest rates before year-end with a further three hikes next year. Albeit at a slow initial pace of $10 billion a month, balance sheet reduction, or quantitative tightening, begins in October – another confirmation that the central bank continues to step away from the ultra-easy monetary strategy, a policy that drove yields to unsustainably low levels.

The healthy employment market is supporting consumer spending trends and evidence suggests that inflation should trend slightly higher in the coming months – hence the Fund's continued overweight position to this asset class via a short-dated US Treasury index-linked issue. Indeed, US breakeven rates have rallied since late August, reflecting the more positive outlook for US inflation. The Fund remains overweight investment grade credit relative to US government debt. At current levels, credit spreads have limited upside, yet with yields still extremely low by historical standards, the additional yield over and above government bond yields remains attractive.

The US Dollar has been under pressure for most of the year, but we see signs of a temporary reprieve in the fourth quarter that may allow us to begin reducing the overweight position. We await a more attractive level to begin building an allocation to Euros as this year's rally may have discounted much of the positive news over the short term. For now, improving, or less negative 'real yields' in the US should continue to lend support to the US Dollar and the proposed drop in the tax rate for companies repatriating overseas earnings could provide some short-term support. In addition, resilient economic conditions in the US economy should underpin the Federal Reserve's willingness to maintain their tightening cycle, putting them out in the lead ahead of many of their global central bank counterparts.

Overall, the strategy remains one of limiting downside risk in an environment where we continue to forecast higher yields in the coming quarters. Global synchronised growth patterns and less accommodative central bank policies should ensure that global government bond yields continue to normalise. We aim to continue to gradually increase the duration of the fund at more attractive yield levels as this process unfolds.

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