

# MONTHLY INVESTMENT REPORT – 31 JANUARY 2023

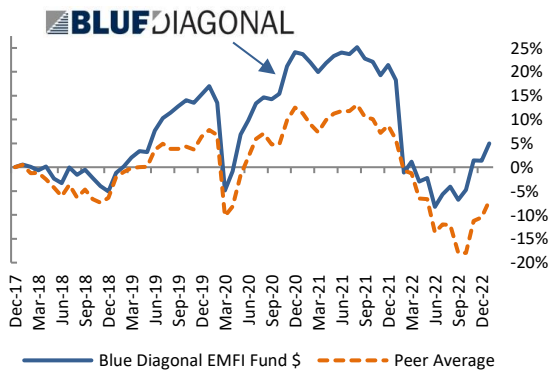
## BLUE DIAGONAL EM FIXED INCOME FUND

Class A (EUR) NAV per share: 0.928710 (0.898974)  
 Class B (USD) NAV per share: 1.136881 (1.097330)

Class A (EUR) Monthly Ret: +3.31% (1y Ret: -13.8%)  
 Class B (USD) Monthly Ret: +3.60% (1y Ret: -11.2%)

### Fund Performance

The Fund started the year strongly returning +3.6% (USD), in line with the performance of the asset class.



Source: Blue Diagonal Capital, Bloomberg

### Macro Environment

After the poor performance of 2022 that saw large losses across both equities and bonds, markets reassessed the prospects for 2023 and put some money to work, lifting both equities and bond markets. EM hard currency debt returned more than +3% for January with the asset class benefiting from strong inflows.

A number of positive developments buoyed markets. The reopening of China after it ended its zero-Covid policy raised the prospects for economic growth in China itself, in Emerging markets on firming commodity prices, and in Europe with its open economy benefiting from global growth. Europe received an unexpected boost from a very warm winter which reduced energy demand, resulting in the levels of gas storage remaining near full capacity and the price of gas falling back to pre-Ukraine war levels.

The positive expectations on global growth helped weaken the US dollar, which lost 10% of its value vs the EUR over the last 3 months, retreating to 1.09. The price of oil seems to have found a floor at \$80pb (Brent Crude) and is likely to trade higher as demand rises in China.

The major central banks are expected to keep raising interest rates until the fight against inflation has been won, despite concerns that a US recession is around the corner.

### Investment Outlook

We consider four likely scenarios in respect of the outlook for EM hard currency bonds this year, and which will determine the positioning of the fund to optimise return vs risk.

Our base case scenario assumes that the US will avoid a recession in 2023, with growth remaining between 1-2%, wage growth remaining strong, and inflation proving sticky around 4%. The FED will maintain policy rates at 5% or higher for longer than the market currently expects. This scenario is supported by the recent strong employment data - new job openings stand at almost twice those seeking employment.

The second scenario is the goldilocks scenario where the US economy enjoys a soft landing with low growth and with inflation dropping to ~2.5% by the end of the year, allowing the FED to start reducing its policy rate in Q3/2023. The remaining two scenarios are stagflation (recession + sticky inflation at ~4%), and a recession that brings inflation down to the 2-2.5% range.

Markets have started the year embracing the goldilocks scenario, encouraged by softer economic data and falling inflation. We believe that the probability of this scenario materialising is receding given recent strong employment data, which is raising the specter of sticky inflation pushing the FED to tighten monetary policy further, leading to a recession.

Emerging markets are expected to benefit from the reopening of China and stronger global growth, supporting a fully invested portfolio in quality EM credits, with a bias toward commodity exporters.

In a goldilocks scenario all bonds irrespective of credit quality should perform. In the other scenarios, low quality credits (B rated or lower) are likely to struggle. A market sell-off and a stronger dollar in the recession scenario will cause credit spreads of low-quality credits to widen significantly. Portfolio construction will be dynamic and reflect our conclusion on the expected dominant scenario.

**BLUE DIAGONAL EM FIXED INCOME FUND (the “Fund”), an investment compartment of Blue Diagonal AIF V.C.I.C. Plc**  
 Blue Diagonal AIF V.C.I.C. Plc is authorised by CySEC (AIF17/2014)  
**The Fund is externally managed by Blue Diagonal Capital Limited, Cyprus**

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The Fund may make use of leverage which could increase the assets under management to more than hundred percent of the net asset value of the fund attributable to investors, which could substantially increase the potential losses that the investors in the fund may incur pursuant to adverse market movements.

Investors may redeem shares on the dates as described in the relevant fund supplement, but investors should note that in volatile markets or where the fund experiences large outflows, the Investment Manager may at his sole discretion suspend the redemption of shares. In addition, the Investment Manager at his sole discretion may impose a redemption charge on any particular dealing date. The factors described above and in more detail in the fund Prospectus and Supplement, may lead to losses which may equal your original investment resulting in a loss of the total sum invested.

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