

# MONTHLY INVESTMENT REPORT – 28 FEBRUARY 2023

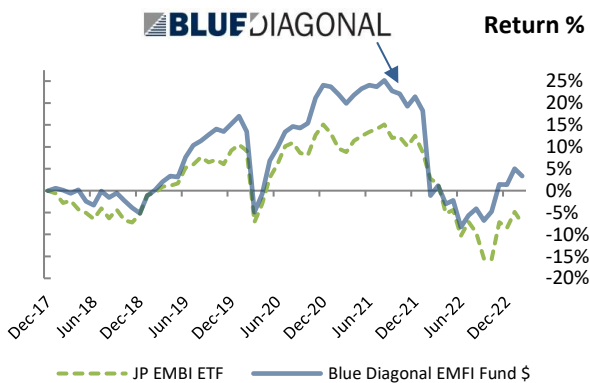
## BLUE DIAGONAL EM FIXED INCOME FUND

Class A (EUR) NAV per share: 0.911872 (0.928710)  
 Class B (USD) NAV per share: 1.118739 (1.136881)

Class A (EUR) Monthly Ret: -1.81% (1y Ret: +2.73%)  
 Class B (USD) Monthly Ret: -1.60% (1y Ret: +4.48%)

### Fund Performance

The Fund gave back some of the strong gains of January (+3.6% USD Class), losing 1.6% whilst outperforming the benchmark JP EMBI Global Index by ~60bp for the month.



Source: Blue Diagonal Capital, Bloomberg

### Macro Environment

The strong bond market returns seen in January reversed in February. Exceptionally strong US jobs data (January Nonfarm Payrolls of +517k vs +189k expected), better than expected economic data, and higher than expected inflation in both the US and across Eurozone countries surprised markets and drove yields higher. 10y US Treasury yield rose 40bp to 3.93% from 3.53%, while the French 10y Gov bond yield rose 40bp to 3.15% from 2.75%.

EM sovereign credit spreads were unchanged on the month at ~370bp, but EM hard currency debt lost 2.2% due to the higher USD yields.

The latest economic data from China was considerably better than the market expected, pointing to strong economic growth of 5-6% for 2023. The confirmation of return of demand from China has boosted commodity prices. The price of Brent oil that has fluctuated in the \$80-85 range, is now expected to rise to \$100 during the year.

The positive economic surprises in the US data gave a lift to the US dollar, reversing its January losses, strengthening to 1.06 from 1.09 against the EUR.

A potential change in the monetary policy framework following the appointment of a new governor at the Bank of Japan has the potential to push global yields higher.

### Investment Outlook

The change in the direction of economic data – both on growth and inflation – has positively surprised markets and provided a headache for central banks in their fight against inflation.

Our analysis points to two likely future scenarios for EM hard currency bonds.

Our base assumption is that the US will record solid economic growth in 2023, wage growth will remain strong and unemployment low, with inflation proving sticky at around 4%. This scenario has now become the market's mainstream view, which is reflected in higher US yields and the expectation that the FED will raise interest rates to 5.75%. We conclude, however, that the FED will keep rates high for longer than the market currently expects.

The second scenario considers an acceptance by the FED that its inflation target of 2% is not achievable in the new world of geopolitical tensions, friend-shoring and climate change. Efforts to drive inflation down to 2% will come at an unacceptable cost to society as the FED will have to engineer a recession and high unemployment that will disproportionately impact lower wage earners, increasing inequality.

With the first scenario largely priced in, the second scenario presents a risk of further downside to the market. Acceptance of inflation at 3-4% as the norm for the foreseeable future will push 10y US Treasury yields higher to 4.5-5.0%, putting further pressure on bond and equity markets.

Emerging markets are expected to benefit from the re-opening of China and stronger global growth, supporting a fully invested portfolio in quality EM credits, with a bias toward commodity exporters. Inflation uncertainty and the tight monetary conditions will put pressure on low quality credits (B rated or lower). We have maintained a low interest rate duration (3-4 years) that is around half of the benchmark, which is reflected in the fund's outperformance vs its benchmark.

**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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Investors should note that past performance does not predict future returns. The performance data do not take account of the commissions and costs incurred on the issue and redemption of units. The fund invests in international securities denominated in foreign currency, and movements in exchange rates will have an effect on the value, either favourable or unfavourable, of such securities. The Fund is exposed to geopolitical risk, and any deterioration in the creditworthiness of countries, and/or the imposition of sanctions on countries may lead to substantial losses for the Fund. Some investments, especially financial derivatives, may display a high level of volatility which could result in the net asset value of the fund experiencing sudden and large falls in its value causing losses when the investment is realised.

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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