

MONTHLY INVESTMENT REPORT – 31 JULY 2023

BLUE DIAGONAL EM FIXED INCOME FUND

Class A (EUR) NAV per share: 0.989671 (0.966224)

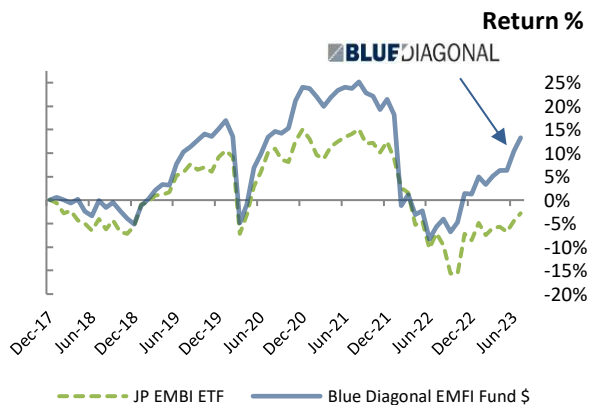
Class B (USD) NAV per share: 1.226687 (1.195652)

Class A (EUR) Monthly Ret: +2.43% (1y Ret: +18.3%)

Class B (USD) Monthly Ret: +2.60% (1y Ret: +20.1%)

Fund Performance

The Fund had a strong performance in July with a return of +2.6%, outperforming the benchmark JP EMBI Global Index by ~100bp for the month, and by 6.3% Year to Date.



Source: Blue Diagonal Capital, Bloomberg

Macro Environment

The economic data coming out of the US continues to provide positive surprises, while inflation has come out lower than expected. Faced with strong economic growth and a buoyant employment market, the FED has hiked its policy rate by 25bp to 5.25% - 5.50% to cool the economy down and bring inflation down to its 2% target. The result of higher GDP growth and lower than expected inflation has raised expectations for a soft landing of the economy, benefiting risky assets (equities and lower credit quality high yielding bonds).

In Europe, while inflation has been falling albeit at a slower pace than in the US, the economy has been struggling and growth appears anemic. The ECB raised its policy rate by an additional 25bp to 3.75%, with another rate hike to 4% possible in September/October.

The price of oil has risen to \$85pb (Brent crude) from \$75pb a month ago as a result of the OPEC+ measures and rising demand.

JP EMBI sovereign bond yield was at 7.85%, 15bps lower on the month. EM credit spread was lower by 30bp to ~335bp, as the 10y US Treasury yield moved higher to 3.96% (vs 3.85% a month ago).

Investment Outlook

The moderate impact that the sharp rise in US rates has had on economic activity has raised questions about the effectiveness of the transmission mechanism from policy rate to economy.

The Fed's monetary policy is facing substantial headwinds from fiscal stimulus (the US is running fiscal deficits in 2023 & 2024 in excess of 5.5% of GDP) and excess liquidity (the pace of Quantitative Tightening (QT) is a modest circa \$1 trillion per year compared to the \$5 trillion of Quantitative Easing (QE) injected during COVID). In addition, the geopolitically driven on-shoring of manufacturing away from China is fueling demand for labour, driving wage costs higher.

Based on the economic outlook and excess liquidity we consider it likely that inflation easing in the near term will be mainly due to base effects, and the 2% target will be difficult to achieve, resulting in the US policy rate staying higher for longer.

A strong US economy with moderating inflation is good for risk-on trades and EM high yielding bonds. Risk-on environments tend to go hand in hand with a weaker US dollar. The growth differential between the US and Eurozone is however increasing, weakening the euro vs the US dollar and making it likely that the US dollar will remain relatively stable against EUR and other major currencies.

EM high yielding debt (BB/B/C rating) has experienced a strong rally despite the higher US rates, reflecting the good value that the EM high yield universe offers, whilst the elevated risk-free yields at the long-end of the yield curve offers an attractive opportunity for duration extension.

Our stance towards high yielding weak credits remains cautious. We consider it likely that poorly run and highly indebted countries will struggle to improve their creditworthiness under the burden of high servicing costs for as long as USD Government bond yields remain at these high levels.

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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