

# MONTHLY INVESTMENT REPORT – 31 AUGUST 2023

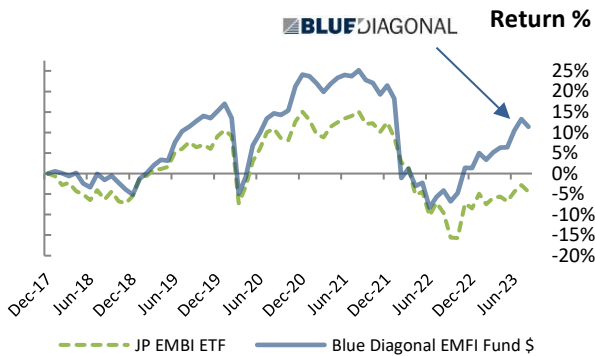
## BLUE DIAGONAL EM FIXED INCOME FUND

Class A (EUR) NAV per share: 0.970953 (0.989671)  
 Class B (USD) NAV per share: 1.205740 (1.226687)

Class A (EUR) Monthly Ret: -1.89% (1y Ret: +14.2%)  
 Class B (USD) Monthly Ret: -1.71% (1y Ret: +16.1%)

### Fund Performance

The Fund's value in August ended lower by 1.7%, broadly in line with the benchmark.



Source: Blue Diagonal Capital, Bloomberg

### Macro Environment

August, a month of low liquidity, witnessed large swings in US Treasury bond yields, especially in bonds with longer maturities. US economic data remains robust with the Atlanta FED model forecasting >5% GDP growth in Q3. Fitch's downgrade of US debt raised the market's attention to the large US fiscal deficits and the lack of a clear strategy to reduce it. The US Treasury also surprised the market by announcing a larger than expected issuance of long-maturity debt and stated its intention to build a \$750bn cash cushion by year-end. The prevailing geopolitical tensions also meant that the traditional foreign demand for US treasuries was reduced. The effect was a 40bp move in the 10y US Treasury bond yield from 3.95% to 4.35% over a 2-week period, bringing the 10y real yield (above inflation) to 2% - the highest real yield since 2008.

By the end of August yields started retracing as softer US data started to emerge, and EU/UK/Chinese economic data continued to disappoint with a weakening / contracting service sector added to the ongoing contraction in manufacturing. China is also facing the fallout from the collapse of some of its largest real estate developers, and the drop in real estate prices.

The price of oil was stable in the \$80s per barrel (Brent crude) following recent intervention from OPEC+ producers.

### Investment Outlook

Our EM sovereign benchmark yield (JP EMBI) ended the month at 8.20% (vs 7.85% a month ago). EM credit spread was higher by 20bp to ~353bp, as the 10y US Treasury yield moved higher to 4.11% from 3.96%.

We consider that the expected easing in US inflation in the near term will be mainly due to base effects, and that the 2% target will be difficult to achieve. Consequently, US policy rate will likely stay above 5% for an extended period of time. EM countries with high USD borrowing requirements will continue to face tight financial conditions, and expensive refinancing costs.

The real US yield of 2% for long-end US Treasuries will cause the fiscal position of the US to deteriorate, with the debt/GDP ratio already above 100% and rising further. EM borrowers pay a credit spread above this yield, and the balance sheets of weaker credits will likely come under pressure.

The US economy, as a large relatively closed economy, is expected to be more resilient than those of the EU/UK/China, causing US dollar strength and compounding the challenges for EM credits/commodity prices.

The real estate troubles in China are likely to cause a slowing in economic growth over the coming years, adversely affecting the broader (ex US) world economy, and softening the demand for some commodities – a negative for selected EM credits.

Investors also have to consider the impact of the continuing geopolitical shifts, as BRICS invite more countries to join the trade block having declared their dissatisfaction with the US led world status quo.

We adopt a cautious EM credit stance with an underweight in credit duration (4.5y vs 7y for benchmark), and underweight the weaker credits whilst interest rate duration has been extended to neutral (7y) to benefit from high US real yields, whilst offering protection against geopolitical shocks and negative economic surprises.

**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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