HIGHER INCOME FUND

COMMENTARY FOR QUARTER TO END SEPTEMBER 2021

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	0.35%	5.38%	24.99%	12.60%	28.23%	102.07%
FTSE AllShare TR GBP	2.23%	7.95%	27.90%	9.53%	29.81%	119.18%
IA Mixed Investment 40-85% Shares	1.32%	6.36%	16.76%	21.75%	40.26%	118.30%
Sector Quartile	4	3	1	4	4	4

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested.

REVIEW

Global equities continued to rise over the third quarter of 2021, but there were considerable regional differences with the US market outperforming, European markets largely drifting sideways, and emerging markets declining. Chinese markets were a particular drag. The Chinese government's more aggressive regulatory stance across a number of sectors was already weighing on markets when news emerged that one of China's largest property developers Evergrande seemed likely to default on its debts, stoking fears of systemic risk spreading across Asia.

It was also a quarter with distinct performance periods, with the markets in July and August seemingly impervious to bad news, and everything coming to a head in September. There was growing concern that supply-driven cost-push inflation was becoming entrenched across many different economies.

PERFORMANCE & ACTIVITY

EdenTree Higher Income Fund returned 0.3% over the course of the quarter, trailing its FTSE All-Share Index benchmark, which generated a total return of 2.2%.

In response to deepening inflation concerns, the US Federal Reserve announced that it would soon begin to slow the pace of its asset purchases and that it was likely to raise interest rates to 1.75% by the end of 2024. This led to US Treasury yields reversing their declines from earlier in the quarter. The Bank of England arguably went further than the other major central banks, indicating that it might raise rates before the end of the year, causing UK government bond yields to rise sharply. In this environment, Fixed Interest markets generally declined, with the FTSE Actuaries UK Conventional Gilts All Stocks falling 1.8% and the IBOXX Sterling Corporates declining 1.0%.

Having been concerned about inflation for some time, we were well positioned for this, having maintained relatively low weighting to fixed interest, and favouring value in the equity portfolio. It is also worth noting that our selective exposure to more specialist areas of the fixed interest market proved effective, with our PIBS investments in particular making material gains over the course of the quarter.

Given the market's concern about developments in China, a major driver of underperformance relative to the benchmark was our allocation to Asia through holdings like Boustead Singapore and Luk Fook. While these were pulled down with the rest of Asian markets, we would not consider any of our holdings in this area as particularly exposed to Chinese real estate. In fact, we took the opportunity provided by this market dislocation to selectively increase exposure to Asia through additions to positions like Greatview Aseptic Packaging and VTech, as well as through a new investment in battery manufacturer Simplo; we were attracted to its strong balance sheet and good cash-generation, trading at a single-digit price multiple of earnings, despite notable growth opportunities.

Our position in Royal Mail also detracted over the quarter, after a period of very strong performance prior to this. Royal Mail published a trading update that met consensus expectations, but that nevertheless represented a decline relative to the previous results and raised some concerns about letter volume recovery slowing at the same time as parcel volumes seemed to stabilise. We reduced our position over the period, following strong performance up to then, but we maintain a holding, as the stock is, at the time of writing, trading at below 7x forward earnings, which represents a material discount to historical averages, and the company has already executed a successful transformation strategy,

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increasing penetration into the more attractive parcel segment and improving its cost structure, supporting the potential for future dividend increases.

Among top contributors to this month's performance were Financials, where we have remained overweight for some time. We think holdings like ABN Amro, Swedbank, Sumitomo Mitsui and Lloyds, which all generated positive performance over the period, are likely to do well in an environment of rising rates and yield curve steepening, which seems likely if inflation remains elevated.

The Fund paid a dividend of GBP 2.80 over the period under review, and we believe the outlook for future dividends is positive, especially given ongoing normalisation of dividend payments from bank holdings in the portfolio.

OUTLOOK

We remain focused on the potential for inflation to persist for longer than many market participants have entertained especially the central banks which seemed too quick to dismiss widespread inflationary pressures as 'transitory. As such, we are comfortable with remaining overweight equities at an asset class level, overweight financials at an equity sector level, and to generally look for opportunities to invest in assets that provide some natural hedging against inflation, such as property. We also are positive about infrastructure, but are mindful risks such as falling long term energy price forecasts, rising corporation and less conservatism in financial assumptions. We also believe that recent economic developments may provide an environment in which the extraordinary valuation gap between growth and value investments could finally narrow, which would be beneficial for our value-oriented investment style.

To obtain further information please speak to your normal EdenTree representative, visit **www.edentreeim.com or call** our support team on **0800 011 3821**

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