

# QUARTERLY INVESTMENT REVIEW

## Fixed Income Absolute Return Strategy

### RETURNS (%) (LOCAL)

	Cumulative (%)		Annualized (%)				
	QTD	YTD	1 Year	3 Years	5 Years	10 Years	ITD
Net of Fees (Composite)	-1.39	3.82	3.82	-4.69	-1.89	-	-0.16
Gross of Fees (Composite)	-1.14	4.87	4.87	-3.73	-0.70	-	1.19
FTSE 3-Mo. T-Bill	1.41	5.26	5.26	2.25	1.91	-	1.72
Value Added (vs. FTSE 3-Mo. T-Bill)	-2.80	-1.43	-1.43	-6.94	-3.80	-	-1.88

### Major Performance Drivers

#### Market Events

Heightened volatility during the fourth quarter produced outsized moves across global interest rate and currency markets. During early October, strong U.S. employment and retail sales data pushed global yields higher, while concerns about the U.S. Treasury's debt issuance plans clouded rates markets. Australian inflation registered above consensus, leading to local market underperformance, while CPI in the Eurozone came in soft. There was a dramatic tone shift in early November when Treasury Secretary Janet Yellen surprised markets by releasing a more benign refunding plan, generating a bid for long duration assets. Central banks were on hold throughout November, but dovish remarks from Fed Governor Christopher Waller late in the month added fuel for the bullish move lower in yields. As December rolled into view, the Bank of Japan began laying the groundwork for stepping away from negative interest rate policy, pushing up the Japanese yen, but the bank ultimately failed to deliver any meaningful policy changes later in the month. Norges Bank unexpectedly hiked rates, driving the Norwegian krone higher. Later in the period, participants were eager for clues on when the Fed would pivot its monetary stance. Despite leaving rates unchanged, Fed Chair Jerome Powell's unwillingness to push back on aggressive cuts priced into STIR markets at the time of December's FOMC press conference was just the catalyst, and another duration rally ensued.

For the quarter, moves in developed interest rate swap markets were material, with the average 10-year swap yield lower by 90 basis points. Swedish rates outperformed, rallying 109 basis points, while Australian rates lagged, down only 57 basis points. Curves, as measured by the yield differential between 2-year and 10-year interest rate swaps, on average steepened 2 basis points but there was wide dispersion. The U.S. curve was steeper by 11 basis points while the Australian curve was flatter by 15 basis points.

G10 currency performance was robust, with all currencies strengthening versus the U.S. dollar. Swiss franc returned +8.8% and Swedish krona +8.2%, while Canadian dollar was the laggard returning +2.5% versus USD. Emerging currency performance painted a similar story, with regional performance strongest in EMEA. In the region, Polish zloty (+11.1%) outperformed, and Hungarian forint (+6.1%) was also strong. Other notable performance included Thai baht (+6.8%) in Asia ex-Japan and Colombian peso (+5.2%) in LatAm.

Inception Date: 31-Oct-16

**Risks:** Risks associated with investing in this Strategy may include: Fixed Income Risks, Currency Risks, Forward Contracts Risks, Options Risks, and Futures Risks. Returns shown for periods greater than one year are on an annualized basis. To obtain performance information to the most recent month-end, visit [www.gmo.com](http://www.gmo.com). **Performance Returns: Performance data quoted represents past performance and is not predictive of future performance.** Net returns are presented after the deduction of a model advisory fee and incentive fee if applicable. These returns include transaction costs, commissions and withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. Fees paid by accounts within the composite may be higher or lower than the model fees used. **GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®).** A Global Investment Performance Standards (GIPS®) Composite Report is available on [GMO.com](http://GMO.com) by clicking the GIPS® Composite Report link in the documents section of the strategy page. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Actual fees are disclosed in Part 2 of GMO's Form ADV and are also available in each strategy's Composite Report. The portfolio is not managed relative to a benchmark. References to an index are for informational purposes only. Gross returns are presented gross of management fees and any incentive fees if applicable. These returns include transaction costs, commissions, withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. If management and incentive fees were deducted performance would be lower. For example, if, before fees, the strategy were to achieve a 10% annual rate of return above its hurdle rate each year for ten years, and an annual advisory fee of 1% and incentive fee of 20% of net returns above the hurdle rate were charged during that period, the resulting average annual net return (after the deduction of management and incentive fees) would be approximately 7.20%.

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## **Major Performance Drivers Cont.**

### Recent Performance

Net portfolio performance was negative during the fourth quarter, as all four models generated losses in the period.

Duration performance suffered from cross-sectional factors, where positions in Australia and Sweden underperformed. Carry and value lagged, though macro and statistical mean-reversion signals provided some relief. Price momentum within the rates model performed well, particularly toward the latter parts of the quarter, and the portfolio was net long global duration as yields trended lower into year end. Within the curve slope strategy, momentum underperformed, driving much of the losses in the model, while valuation indicators added value.

In G10 currencies, cross-market selection pulled down performance, primarily from short Swiss franc and long Japanese yen positioning, and net U.S. dollar timing compounded losses. Through a factor lens, price momentum lagged, as did carry, while long-term macro-based gauges were positive. The emerging currency strategy similarly struggled from market selection and U.S. dollar timing. Currency selection in the EMEA region was most underwhelming, a byproduct of price and yield momentum.

## PRODUCT OVERVIEW

The GMO Fixed Income Absolute Return Strategy seeks to generate positive absolute returns by exploiting opportunities in global fixed income and currency markets.

GMO employs quantitative models for forecasting and valuing rates and currency markets, as well as for allocation and trading strategies. Our models use market-based, macroeconomic, and fundamental inputs in conjunction with proprietary research to evaluate and identify investment opportunities.

## IMPORTANT INFORMATION

**Comparator Index(es):** The FTSE 3-Month Treasury Bill Index is an independently maintained and widely published index comprised of short-term U.S. Treasury bills.

**The above information is based on a representative account in the Strategy selected because it has the fewest restrictions and best represents the implementation of the Strategy.**

## ABOUT GMO

Founded in 1977, GMO is a global asset manager committed to delivering superior performance and advice to our clients. We are privately owned, which allows us to singularly focus on our sole business – achieving outstanding long-term client investment outcomes. Offering multi-asset, equity, fixed income, and alternative strategies, we invest with a long-term, valuation-based philosophical approach.

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