Dodge & Cox Funds®

Video Transcript
February 21, 2018

2017 Global Bond Fund Review

Question: How did the Global Bond Fund perform in 2017, and what were the main drivers of performance?

Lucy Johns: The Global Bond Fund had strong performance in 2017, returning a bit over 8%. And for context, this is almost a percent higher than the benchmark returned. Importantly, the Fund's returns were sourced from the three main levers that we use in managing the portfolio: credit, currency, and rates. In terms of the broad backdrop for the markets this year, it was really quite supportive. We had a period of strong, broad-based growth across developed and emerging economies, strong corporate profitability, commodity prices that were stabilizing and then increasing in the latter half of the year, and low market volatility. In this environment, credit bonds did particularly well, as yield premiums declined, really throughout the year, driving strong performance. This really benefited the Fund because we have a large allocation to credit, and in addition, several specific bonds did particularly well, exhibiting strong security selection. Some of the examples of those outperformers are Rio Oil Finance Trust, an asset backed security from Brazil, Telecom Italia, and NASPERS, the South African-based media company. Like in 2016, in 2017 credit was the largest driver of performance for the Fund. What happened in the currency markets was also interesting. Unlike in the prior two years, in 2017 the U.S. dollar declined on a broad, trade-weighted basis. So that means that it was generally better to hold non-U.S. currencies, and this benefited the Fund. It's worth noting that the euro and euro-related currencies were particularly strong performers during the year. This was partly due to better than expected growth and other economic indicators in that region. The Fund does not hold much exposure in those areas and so didn't benefit as much from that. But the Fund does have substantial weighting in emerging market currencies and did particularly well in that area. Notably, the Fund's largest emerging market holding, the Mexican peso, did particularly well. It was up 14% during the year and was one of the larger contributors to the Fund. So overall, 2017 was a good year for the markets and a successful year for the global bond strategy.

Question: What were the primary changes to the portfolio during 2017?

Lucy Johns: The most notable change to the portfolio during the year was approximately a 10 percentage point decline in the corporate weighting of the Fund, as we selectively trimmed a number of individual bond holdings. And this was largely valuation driven, in this environment of declining yield premiums that we've seen credit yield premiums are now at 10-year lows and thus we're not finding as much conviction in this part of the investment universe. So overall fundamentals are strong and we maintain a large position but we have trimmed back substantially. In terms of where wer're reinvesting these proceeds, they've largely been invested in low-duration, high-quality bonds. Mainly, we're building dry powder within the Fund to take advantage of future opportunities. But we do use security selection and fundamental research to find interesting ideas within this part of the market. Some of the things that we bought recently have been unique opportunities within the mortgage-backed and asset-backed security markets. We've also purchased Japanese Treasury bills and hedged them back to dollars, which has created some additional income relative to U.S. Treasuries. So we are continuing to find value there. The other thing we've been adding to in the portfolio is emerging market local debt, so debt that's denominated in the home currencies of the emerging markets. Some of the countries we've invested in more recently include Indonesia, Poland, and Argentina. In these cases, we feel the risk/reward proposition is quite attractive. In many cases, these nominal and inflation-adjusted yield levels are quite attractive, the currency valuations are reasonable, and we believe that the macroeconomic outlook is stable to improving. In terms of duration, overall there wasn't a large change during the year in 2017. We remain defensive in terms of taking on interest rate risks and want to mitigate that, so we maintain a relatively low duration across the portfolio.

Question: What is your outlook for the global fixed income markets?

Lucy Johns: We're cautiously optimistic on the outlook for global fixed income. On one hand, we believe our emphasis on security selection really enables us to find value in any market environment. We continue to find opportunities in individual issuers, countries, and sectors that are attractively priced. On the other hand, we acknowledge that the level of yields across the markets are quite low and credit yield premiums have declined to a level that probably limits upside from here, certainly not the type of upside that we've seen in recent years. So that tempers our overall return expectation. Ultimately, we believe our stable and experienced investment team, our long-term investment horizon, and our emphasis on fundamental research will serve our shareholders well.

Dodge & Cox Funds SEC Standardized Average Annual Total Returns as of December 31, 2017: 1 Year 8.31%; 3 Year 3.34%; 5-Year 2.86%; Since Inception (December 5, 2012) 2.86%.

A private fund managed and funded by Dodge & Cox (the "Private Fund") was reorganized into the Fund and the Fund commenced operations on May 1, 2014. The Private Fund commenced operations on December 5, 2012, and had an investment objective, policies, and strategies that were, in all material respects, the same as those of the Fund, and was managed in a manner that, in all material respects, complied with the investment guidelines and restrictions of the Fund. However, the Private Fund was not registered as an investment company under the Investment Company Act of 1940 (the "1940 Act"), and therefore was not subject to certain investment limitations, diversification requirements, liquidity requirements, and other restrictions imposed by the 1940 Act and the Internal Revenue Code, which, if applicable, may have adversely affected its performance. Expense reimbursements have been in effect for the Fund since its inception. Without the expense reimbursements, returns for the Fund would have been lower.