

2024 Annual Global Fixed Income Review

JANUARY 2025

Alka: Hello, everyone. Happy New Year! Welcome to Dodge & Cox's 2024 Global Fixed Income Review. My name is Alka Singal, and I'm a Client Portfolio Manager at Dodge & Cox. It's my pleasure to be joined by my colleague Matt Schefer, Investment Committee member and Credit Analyst. Matt, thank you very much for joining us today.

Matt: Thanks. Happy to be here.

Alka: For the next 20 minutes, we'll provide everyone with an update on the global fixed income market backdrop, our performance and drivers of the performance for 2024, and finally where we've been finding opportunities and changes within the portfolio. Before we jump into specifics, Matt, what are your key takeaways for global fixed income markets in 2024?

Matt: At a high level, I think what I'd note is that 2024 was a busy year in terms of macroeconomic and political developments around the world, which in turn led to meaningful changes in interest rates, currencies, and credit spreads. Through this period, our Investment Committee was particularly active in repositioning the portfolio as a result of our bottom-up research. Based on all these opportunities that we found and the valuations that we're seeing in the market, we're quite excited about the potential return prospects for the Global Bond Fund in the coming years.

Alka: Let's start the discussion with that global market backdrop. You talked about numerous crosscurrents. Let's focus on interest rates to begin with. Looking at the top left-hand page of slide five, we see that rates generally rose on the long end. What other comments would you add to this and markets would you highlight?

Matt: Maybe to start with the United States: year over year, the 10-year yield rose about 70 basis points, but it was pretty bumpy along the way. Really, the three drivers that I'd focus on would be growth, inflation, and politics. Just to give you a sense on the growth angle, for example, coming into the year, markets or economists in general were expecting about 1.3% real GDP growth here in the United States. As we wrap up the year, it seems like real GDP growth may have been closer to 2.7%, so nearly double or more than double what the market had been expecting. So, we think this has been a pretty meaningful driver overall. I think the markets are trying to come to grips with the fact that growth remains robust despite the fact that interest rates have been kept quite high.

So, it's really called into question: what is the appropriate long-term interest rate outlook for the market? On top of that, we had the [U.S.] elections this fall as well, and raising questions around the fiscal outlook for the United States. Putting those together, it led to a pretty meaningful increase in yields year over year.

As we look across the rest of the world, it really depends on country-specific developments. Certainly, some countries were more correlated with the United States, but I think especially when we get to emerging markets, domestic developments come to dominate in what we saw. If you look in South Africa, for example, the 10-year yield declined by about 100 basis points year over year, reflecting a market-friendly election outcome over the course of the summer. Conversely, if you look at Brazil, the 10-year yield rose nearly 500 basis points to 15% due to fiscal concerns that the market had. So, overall, I think it's right to say that interest rates generally rose, but it's a very nuanced story based on country-by-country developments.

Alka: Yes, and you also have in the United States, the central bank did finally initiate cuts but they cut 100 basis points. Now, the pace of cuts seems to be reduced in terms of pricing by the market.

Matt: I think that's right. If we were to go back to the beginning of 2024, the market had been pricing that interest rates would eventually get back down to [approximately] 3%. Whereas, when we wrapped up the year, given the strong growth that we've seen and the fact that inflation is not yet back to target, the market is still pricing that the Fed (federal) funds rate will actually end up at [around] 4% at its trough. And so, this is a meaningful repricing in terms of long-term interest rate expectations by the market.

Alka: Stronger growth in the United States and higher long-term yields certainly contributed to a strong U.S. dollar during the course of the year, in particular in the fourth quarter. On the top right-hand side, you can see the currency performance versus major markets throughout 2024. Matt, what are some observations you would make on currency and the appreciation of the U.S. dollar during the year?

Matt: Looking at the broad trade-weighted dollar, it strengthened by about 6% to 7% quarter over quarter and about 9% year over year. If you were to look back at this series over time, I think what you'd find is that the last time the U.S. dollar strengthened by this much in a single calendar year was 2015. And so, it's been nearly a decade since we've seen an FX (foreign exchange) move of this magnitude overall.

Returns represent past performance and do not guarantee future results. Investment return and share price will fluctuate with market conditions, and investors may have a gain or loss when shares are sold. Fund performance changes over time and currently may be significantly lower than stated above. Performance is updated and published monthly. Current month-end performance can be obtained at dodgeandcox.com or call 800-621-3973.

In terms of the drivers of this move, certainly the U.S. exceptionalism that we've seen, the fact that U.S. growth has held up better than many other countries, [and] the fact that U.S. interest rates are relatively high versus what we see in many other developed markets have certainly been tailwinds to the U.S. dollar. Beyond that, fears around tariff policy from the United States going forward and what that can mean for the [U.S.] dollar has been a contributor as well.

Alka: So while we saw generally interest rates that are higher on the long end as well as a stronger U.S. dollar, the one story that seemed to be very consistent during the course of the year was ongoing strength in the credit markets and credit spreads going tighter throughout the year. If you look at the chart on the bottom left, what elements would you highlight that contributed to some of the strength in credit markets?

Matt: I would point to, I think, two factors on this. The first comes back to that robust growth backdrop that we have already discussed. Credit securities are pricing default risk. To the extent growth is better than expected and to the extent recession risk is lower than expected, that should be positive for credit markets. We've seen that reflected in credit valuations overall. Above and beyond that, I would also mention that just given the higher level of yields that we're seeing in fixed income markets, there are a lot of inflows into this asset class at the moment, whether that be into Treasury securities, whether that be into Corporate securities, whether that be into other portions of the market. As those funds have been coming into the fixed income markets, we believe that's also been supportive of credit valuations.

Alka: Now the last chart on this page shows performance across various indices. The one thing I would just draw our listeners to is the fourth-quarter returns, where you see a lot of negatives across different indices. A lot of that was driven by the U.S. dollar appreciation during the quarter. If we move then to Global Bond Fund performance, we do see on page six that the Fund returned a positive absolute return in the year, despite these numerous elements in the market. The Fund returned 0.57%.¹ Matt, can you please contextualize performance?

Matt: Sure. So, I think if we were to start with the longer-term view, looking back 10 years, for example, the Fund has returned about 3.5% per year over the past decade. We're quite happy with that long-term performance, both in terms of the absolute number as well as relative to the 2% annualized return of our benchmark index. However, given some of the more recent market moves that we've talked about, particularly on currencies [and] interest rates, it has been a bumpier, more challenging environment of late. And so, a negative 5% return in the fourth quarter left us in only slightly positive territory for the year.

Alka: If we look at drivers of the performance in greater detail, the three drivers that we break down performance by are currency, duration/yield curve, and excess returns. On slide seven, you can see excess returns were very strong for the Fund over the course of the year, and the main detractor to performance was currencies. Matt, can you dive into detail on these different levers?

Matt: Absolutely. So, I think as we look across the drivers of performance, from a big-picture perspective, it's encouraging to see

that there were some benefits to diversification. We try to put together a portfolio that can do well across different environments. Certainly, in an ideal world, hope that currency, interest rates, and credit would all positively contribute in all environments. While that certainly wasn't the case for this past year, it was encouraging to see that while we underperformed due to our currency exposures, that was more than offset by the gains we had on credit. Looking a bit under the hood, the credit exposure contribution of 3.4 percentage points came down to a few things. First of all, given that credit spreads performed well overall, just simply having any exposure to credit was beneficial. Beyond that, we are bottom-up security selectors—we are investing in individual companies for individual reasons.

As we look at the drivers or components of our 3.4% contribution to return, we do see that a number of individual companies that we chose performed quite well over the year. In Mexico, for example, Pemex,² which is the national oil company, was the single largest contributor within our credit holdings. Charter Communications, which is a U.S. cable company, also performed strongly. This gives us some reassurance as well that this wasn't simply a bet on a sector but it really is about doing bottom-up, individualized research across our Credit [sector holdings]. Moving away from Credit and looking at the yield curve, despite the fact that interest rates rose quite meaningfully year over year, this component was about flat. The important takeaway on this component is that it illustrates the importance of yield or the importance of income that we earn.

Finally, on currency, it did detract 2.7 percentage points from our return. There were frankly very few places to hide over the course of the year. I think there are only a small handful of currencies that actually outperformed the U.S. dollar year over year. We are certainly not pleased with that deduction. I think as we look forward from here, we do believe the U.S. dollar is quite overvalued against a number of currencies. That gives us increased optimism about prospective returns from here.

Alka: Thank you. You talked about bottom-up, individualized research when it comes to Credit. That certainly can be seen when we look at changes in the portfolio for the year and trims that we made to individual names as well as select adds. What are some items you would highlight for our listener when it comes to that individual research?

Matt: To start, I'd point out that even though there are a lot of individual companies mentioned on this left-hand side, you may think we must be trimming the portfolio in broad brush [strokes]. The reality is it is a bottom-up, name-by-name assessment. We have a large team of [Global] Industry Analysts working closely with a team of Credit Analysts, combing through our portfolio, combing through the opportunity set to understand where we are getting paid for taking risk and where we are not being compensated for risk. As we went through the portfolio this most recent year, I would say the Banking sector stuck out to us as an area that was no longer justified as a large position as what we previously had. We trimmed about five percentage points out of our bank weight,³ so that accounted for about half of our credit trims overall.

This is not to say that we are fearful about the Banking sector. In fact, we still have a lot of confidence in the individual bank [securities] we own. We believe the fundamentals are strong, capital levels are high, the liquidity is good, but we no longer believe that banks needed to be as large as they were previously [in the Fund]. Yet, even after trimming five percentage points, banks remain the single largest sector holding we have within the Fund. Beyond all of those Credit trims, I think it is encouraging and a testament to our bottom-up research that we do continue to find incremental opportunities to put money to work within the credit space. And so, for example, we added to CVS [Health], Colombia, TC Energy, and Romania primarily over the course of the year.

Maybe to use CVS as an example. This is a leading health care and pharmacy services company. The management team has been very focused on improving execution of their strategy. In order to defend their balance sheet and strengthen their credit metrics, they issued subordinated debt during the fourth quarter of the year. This is an area of the market that we have been very focused on over time. We own a number of other subordinated investments in the Fund. We were able to purchase these CVS subordinated bonds at about a 7% yield, which is a meaningful discount relative to where CVS's senior securities trade. That is a very interesting opportunity for us.

Alka: Taking a step backward, we trimmed around 10% from Credit this year. If you think about this in the context of the Global Bond Fund, where does that stand?

Matt: We ended the year at about 37% to 38% Credit. To give you a broader sense, we peaked at about 60% at the end of 2022. And so we trimmed over the course of 2023, and then we continued to trim over the course of 2024 as spreads continued to move tighter and tighter.

Alka: You can see that reduction in Credit if you look at the summary of portfolio changes on the bottom right-hand chart. If you look at that Corporate weight, you can see that we've steadily trimmed from Corporate over the course of the year. It is has been over the past two years as Matt alluded to. Where we were finding opportunities in 2024 was in Securitized, specifically we added around 7% to Agency⁴ mortgage[-backed] securities. Matt, can you talk a little about that opportunity?

Matt: The good news has been that as we've trimmed Credit, there have been attractive other alternatives within the portfolio. We have a whole team of analysts focused on securitized products. Within that space, which we generally view as the lower-risk, lower-return portion of the Fund, there were a number of Agency mortgage-backed securities and auto ABS (asset-backed) securities, among others, that we found to be quite attractive. These are not going to be the best-performing securities in the portfolio, but that's not what they're expected to be or designed to be. Rather, these are highly liquid securities. We expect them to outperform comparable-duration government bonds. To the extent credit spreads become more interesting going forward, for whatever reason that might be, we can quickly reallocate capital out of securitized products and back into Credit.

Alka: Great. Now let's talk about currencies. On the chart on the top right-hand side, you see major changes in currency exposures. Can you talk a little bit about what it is that we are looking for when we're investing in currencies, how we invest in currencies, and maybe weave in some of those changes in that context?

Matt: We've spent a lot of time over the years thinking about the drivers of currencies over our multi-year investment horizon. A lot of that work has really come down to the importance of valuation. There are a number of ways to define valuation, but ultimately, we're trying to find the signal for understanding: is a currency more likely than not to appreciate over our investment horizon? Beyond valuation, we pay a lot of attention to the level of short-term interest rates, trying to understand what are we being paid on a nominal basis and what are we being paid on an inflation-adjusted basis. We are looking at other country fundamentals as well: governance, whether they are a net importer or exporter. There's a long whole laundry list of factors we consider. Ultimately, it's not a formulaic assessment; it's really about applying the judgment of our team to identify where we think the best risk/reward lies within foreign currencies.

All that said, I think we realize that currency forecasting can be challenging. As a result, we try to make sure that the portfolio is not overly reliant or overly exposed to currency risk. For that reason, we generally keep the currency exposure capped at 25% or so, which is roughly where we are currently.

In terms of the trades we did during the year, of which you can see some larger ones here, I think the Mexican peso is a nice case study of these tenets. The Mexican peso had been one of the better-performing currencies in recent years, but it faced a number of key risks in 2024, including the Mexican elections in the summer, the U.S. elections in the fall, and a number of other items as well. As we were looking at what price were we paying to own the Mexican peso versus what does the risk/return look like going forward, we decided the Mexican peso still deserves to have a role in the portfolio but not in the same size as before. It ended up being our largest trim over the course of the year.

Similarly, the Malaysian ringgit was perhaps one of the best-performing if not the best-performing major currency in the world over the course of 2024. So, in the fourth quarter, we trimmed exposure there, acknowledging some of the challenges facing Asia and the fact that we didn't necessarily believe we were being adequately spotted (compensated) for the valuation. Conversely, we added to Brazil. This is a currency that was a major underperformer over the course of the year in part due to fiscal and other governance concerns. We continue to believe that the Brazilian real ought to strengthen over time. Given the very substantial level of interest rates that we are receiving there, we made this addition to the portfolio over the course of the year.

Alka: Now what this slide doesn't show, but is shown in our portfolio structure, is the overall duration of the Fund and changes that we made to the duration of the strategy over the course of the year. So, the duration of the Global Bond Fund ended the year at 6.3 years. Can you speak a little bit to changes that the Investment Committee made throughout the year, both in terms of the level of duration as well as regions?

Matt: Interest rates were certainly one of the more interesting opportunities for us over the course of the year. We increased duration at the portfolio level from a little bit under 5.5 years to that 6.3-year level. We added duration across a number of countries, although certainly the United States was the largest component. We continue to believe that U.S. interest rates, as priced by the market, are more likely than not to decline over the coming years. We also believe U.S. Treasuries can serve as a unique role as a recession hedge and help mitigate any sort of drawdown in the portfolio to the extent that there is a recession or other risk-off events. That was the largest component duration add that we had. Importantly for us, interest rates do not move equally across all markets at all times, so there are diversification benefits as well to be had. To give you an example of that, over the course of the summer, we added some duration in the Eurozone. The Eurozone is a market that has lower growth rates and lower inflationary pressures relative to the United States. We think that is a distinctly different risk/return opportunity set versus what we are facing here in the United States. Beyond the Eurozone, we added a small amount of duration in the United Kingdom as well as to a number of emerging markets where we believed that the risk/reward justified increasing or adding to our exposure.

Alka: For context for our listeners, 6.3 years is the highest level of duration the Fund has had, and that is contributing to the yield of the Fund, which is at 5.8%. We've talked about a lot of the overall structure of the portfolio during this call. Matt, I turn it to you to talk about the outlook for the Fund and where is it that the Investment Committee is looking forward to ahead in 2025?

Matt: Certainly. So, I think as we look across the global bond universe, we're seeing a lot of opportunities out there for long-term oriented, bottom-up investors like ourselves. We've already talked about Credit and the fact that credit spreads have narrowed quite significantly, so we have been derisking and moving up in quality within the Credit portion of the Fund. Where we are finding better opportunities perhaps, certainly on the interest-rate side, as we talked about, we believe interest rates could decline in a number of markets going forward, which can provide a nice tailwind to returns. Finally, on the foreign currency side, given what we believe to be a broadly overvalued U.S. dollar, we think the roughly 24% of the portfolio denominated in foreign currencies could perform quite well in the coming years. You can see some of our larger currency exposures on the bottom right of slide nine. In general, what these have in common is undervalued exchange rates and, in some cases, very substantial yields as well, particularly in the case of Brazil. I think we were very constructive on that foreign currency component. I think when we put it all together—a 5.8% starting yield coupled with foreign currency tailwinds coupled with potential for declining long-term interest rates—we think adds up to what could be a quite nice return profile in the coming years.

Alka: Well, thank you for your insights, Matt, and thank you, everyone, for listening to our audiocast and for your confidence in Dodge & Cox. We hope that you have a wonderful year ahead.

The Global Bond Fund — Class I SEC yield calculated for December 31, 2024 was 5.06% using net expenses and 5.00% using gross expenses. This material must be accompanied or preceded by the Fund's [prospectus](#).

Dodge & Cox Global Bond Fund — Class I SEC Standardized Average Annual Total Returns as of December 31, 2024: 1 Year 0.57%, 5 Years 2.84%, 10 Years 3.45%. Fund and Index standardized performance is available on our [website](#).

Global Bond Fund's Ten Largest Positions (as of December 31, 2024): Fannie Mae (12.4% of the Fund), U.S. Treasury Note/Bond (10.4%), Freddie Mac (9.4%), Japan Government (3.8%), Brazil Government (3.8%), Norway Government (2.8%), Colombia Government (2.7%), Mexico Government (2.5%), TC Energy Corp. (2.4%), and Petroleos Mexicanos (2.3%).

1. All Fund performance results are for the Global Bond Fund's Class I shares.
2. The use of specific examples does not imply that they are more or less attractive investments than the Fund's other holdings.
3. Unless otherwise specified, all weightings and characteristics are as of December 31, 2024.
4. The U.S. Government does not guarantee the Fund's shares, yield, or net asset value. The agency guarantee (by, for example, Ginnie Mae, Fannie Mae, or Freddie Mac) does not eliminate market risk.

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