DODGE & COX FUNDS®

Video Transcript
February 7, 2017

2016 Global Bond Fund Review

Lucy Johns: Hello. I'm Lucy Johns and today I'm joined by my colleague, Jose Ursua.

Jose Ursua: Hello.

Lucy Johns: We're going to discuss the performance, positioning, and outlook for the Global Bond Fund starting with performance. We're coming off a very strong year. The total return of the fund was just over 8-1/2% and this is strong on an absolute basis but also on a relative basis. As we think about the drivers of this performance, the largest factor was credit securities, not only a high weighting in credit securities but strong security selection within the credit universe. And some of the largest outperformers were commodity related or emerging market holdings. This highlights not only the strength and depth of our credit research team and process, but also the important role that credit can play within a global bond portfolio. So we're closing out a great year for performance but it was a rocky year in the markets. Why don't you hit on some of the highlights?

Jose Ursua: That's right. 2016 was a year of large macro shocks and also large moves, historic moves, in asset prices, almost one per season. Early in the year we had the surprise Chinese evaluation of the renminbi. Further, declines in commodity prices to multiyear troughs. These factors led to big selloff moves in emerging market assets and to appreciation of safe haven currencies. Later in the summer the Brexit vote led to further appreciation of some of these safe haven assets, including the Japanese yen, and to a big selloff in the British pound, which we had, by the way, hedged fully ahead of the event. And later in the fall, the Republican victory in the U.S. elections led to a sharp selloff in Treasuries or safe haven securities; also led to a big rally in equities and it also led to a big strengthening of the U.S. dollar. And finally, in December, although it was somewhat anticipated, the Fed's hike came on the back of relatively better than expected momentum on the inflation and employment fronts.

Lucy Johns: So lots of ups and downs in credit, interest rate, and currency markets but on net, credit spreads generally tightened throughout the year, providing that strong performance backdrop we talked about. Interest rates rose modestly in the U.S. but fell in major markets outside the U.S. and the dollar, the U.S. dollar, generally appreciated, rising about 5% on a broad trade-weighted basis, which provided a headwind for owning non-dollar securities. Why don't we move on to the macroeconomic backdrop?

Jose Ursua: Certainly, well boiled down to the very basics, what we would expect for this year is rising global growth on the back of the strengthening or the acceleration of growth in some of the major economies, including the U.S. Second would be a world of rising inflation in developed markets on the back of the narrowing of economic slack and as monetary policy easing continues to gain traction, the decline in inflation in emerging markets after a couple of years of overshoots. And also a world of either stable or rising commodity prices, especially oil. The fourth point would be it'll also likely be a world of rising interest rates. This relates to the credit cycle, around which we remain constructive and we think that most of the corporates which we have exposure to have improved or have very resilient balance sheets that we allow to cope with this world of rising rates, especially if it comes on the back of a strengthening of the economic fundamentals. And finally, very importantly, we think we're going to live in a world of increased and higher than usual uncertainty.

Lucy Johns: Yes, uncertainty is quite topical these days. Why don't you elaborate on the sources of political and economic uncertainty?

Jose Ursua: Sure. On the sources of political uncertainty, I would divide them into two groups. First, U.S. related. First and foremost, the incoming administration and Congress mix are likely to lead to policy changes, some of which may have positive effects. For example, a more competitive tax system, an emphasis on lessened or more scaled-back regulation in some sectors, and also an emphasis on infrastructure spending. On the potential negative side, I would include increased protectionism, anti-immigration biases, also market distortions, and potentially also increased geopolitical tensions. There is also on the other side, outside of the U.S., the potential reaction of other countries to these policy changes, in addition to scheduled elections in France and Germany, the Party Congress in China, and of course processes and events related with Brexit itself. On the economic front, there are also sources of big uncertainty. The first one is how economies actually perform on the back of these major, potentially structural policy changes, would be one. Second, how some emerging markets that have accumulated huge imbalances continue to digest these, especially China with a big leverage. The third point would be how central banks are reacting to the evolution of financial conditions in their respective economies and globally as well. The best example of that is how the Fed makes choices around the hiking cycle, the pace and the speed at which it takes it. And the fourth point would be there's uncertainty around how global asset markets as a whole are going to be able to digest a world of rising interest rates in the U.S. and other developed economies.

Lucy Johns: Thank you, Jose. So it sounds like a challenging year, but uncertainty and volatility in the markets can create opportunities for long-term investors like us and we're confident that the Fund is well positioned to perform in a variety of the scenarios that you described.

Jose Ursua: India, for example, in credit we're finding good risk/reward opportunities.

Lucy Johns: That's right, and we're particularly positive about our individually selected holdings, which were chosen for their fundamental outlook and their strong downside protection. While credit valuations are not as attractive as they were say a year ago, they remain attractive relative to government bonds and we still own over half of the portfolio in credit securities. When we think about the interest rate positioning and currency positioning of the Fund, we're a bit more defensive. The duration of the Fund, a measure of the interest rate sensitivity, is about 3.7 years. This is relatively low, signaling that view that rates may rise and create a headwind to returns. In terms of currency, 85% of the Fund is in U.S. dollars. This illustrates not only that we think the dollar may rise, especially relative to other developed market currencies, but also that we're extremely selective about choosing our non-dollar exposures within the portfolio, really only selecting securities that have very compelling risk/reward propositions. What would you highlight here?

Jose Ursua: Well there are two principles that we follow in this careful security selection process. The first one is a principle of diversification. That means trying to find exposures that might counterbalance each other in case different scenarios materialize. A good example of that is our position on India that somewhat counterbalances our more commodity sensitive exposures to Columbia and Peru. And the second principle is to have a relatively higher weight in good fundamental stories that we think are currently mispriced, especially in the Mexican peso.

Lucy Johns: So we're happy to have ended 2016 on a high note and feel good about the outlook and our positioning as we look forward. We're confident that the hallmarks of our investment approach, such as a long-term time horizon, careful security selection, and strict price discipline will continue to serve our shareholders well. Thank you for joining me today.

Jose Ursua: Thank you.

Lucy Johns: And thank you for joining us.

Dodge & Cox Funds SEC Standardized Average Annual Total Returns as of December 31, 2016: 1 Year 8.64%; Since Inception (December 5, 2012) 1.56%.

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.

Statements in this presentation represent the opinions of the speakers expressed at the time the presentation was recorded, and may change based on market and other conditions without notice. The statements are not intended to forecast or guarantee future events or results for any product or service, or serve as investment advice. Debt securities are subject to interest rate risk, credit risk, and prepayment and call risk, all of which could have adverse effects on the value of an investment. Investing in non-U.S. securities may entail risk due to foreign economic and political developments; this risk may be higher when investing in emerging markets.

The information provided is not a complete analysis of every material fact concerning any market, industry or investment. Data has been obtained from sources considered reliable, but Dodge & Cox makes no representations as to the completeness or accuracy of such information. The information provided is historical and does not predict future results or profitability. This is not a recommendation to buy, sell, or hold any security and is not indicative of Dodge & Cox's current or future trading activity. Any securities identified are subject to change without notice and do not represent a Fund's entire holdings.

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. Before investing in any Dodge & Cox Fund, you should carefully consider the Fund's investment objectives, risks, and charges and expenses. To obtain a Fund's prospectus and summary prospectus, which contain this and other important information, or for current month-end performance figures, visit dodgeandcox.com or call 800-621-3979. Please read the prospectus and summary prospectus carefully before investing.