Standard Life Diversified Income Fund

31 March 2022

Activity

The main asset allocation change this quarter was a reduction in our exposure to our sustainable core equity allocation and increase in our allocation to EM debt. Following the strong run that equities have had in 2021, we believe that their return prospects over the medium term are lower. We are conscious of rising risks, particularly from inflation being more persistent than expected and leading to rising interest rates and a re-rating of equities. The risk-return trade-off for equities has therefore become less attractive. By contrast, EM local-currency bonds have seen rising bond yields and real rates. This means that prospective returns are now higher than they were earlier in the year.

Within infrastructure, we added two new holdings, Patheon Infrastructure and Harmony Energy Income Trust. Pantheon is targeting 8-10% net returns by investing in co-investment infrastructure opportunities globally. These are sourced through Pantheon's existing relationships and offer investors access to a high-quality pipeline of assets. Harmony is looking to invest in a portfolio of utility-scale energy storage assets in the UK, in order to take advantage of the significant and growing market opportunity for flexible generation assets. Management have a long-standing relationship with Tesla and the near-term pipeline will benefit from fixed price delivery of Tesla batteries.

Within property, we took part in several attractively priced capital raisings and reduced other holdings on valuation grounds.

Portfolio positioning and outlook

Global equities fell in aggregate over the first quarter of 2022. Investors sold shares, concerned about the Russian invasion of Ukraine, as well as the impact of rising interest rates and accelerating inflation. Geopolitical tensions between Ukraine and Russia weighed initially on markets in January, but the biggest falls came on 24 February when Russian troops invaded Ukraine and launched attacks. While the incursion continued throughout March, investor confidence recovered from the initial shock, and global markets generally rebounded. US equities were particularly strong in March but fell overall for the quarter, amid poor performance for technology stocks in the first two months. European equities were hardest hit by the conflict, whereas the UK market posted a positive return overall, boosted by its exposure to energy and commodities companies. Japanese indices fell but by less than other developed peers.

Central banks continued to withdraw market support over the quarter, signalling higher interest rates to come in 2022, amid rising inflation rates. The Bank of England raised rates twice over the period to reach 0.75%, while the US Federal Reserve (Fed) increased the US federal funds rate by 0.25 percentage points. The European Central Bank announced a quicker tapering of its asset-purchase programme, even as the region faces threats from the Ukrainian invasion. In response to the hawkish moves, investors continued to sell government and corporate bonds, pushing yields higher. At one point, the US yield curve briefly inverted, as the two-year yield rose above 10-year bond yields, which analysts interpret as a sign of a coming recession.

The Russia-Ukraine conflict is likely to dominate news flow in the short term, with the conflict adding to the challenging macroeconomic backdrop for global equities, as well as putting more pressure on energy and commodities. Markets will remain volatile, with the Omicron variant, rising inflation, higher rates and the slowdown in China also weighing on sentiment. That said, many of the risk factors throughout 2021 have moderated, with global vaccination rates rising and the direction of Chinese policy becoming clearer. The fourth-quarter reporting season also suggests that earnings are holding up quite well, despite cost pressures and supply-chain disruption.

Within fixed income, investor attention will likely focus on how effective central-bank measures to control inflation will be, especially with the Russia-Ukraine conflict exacerbating rising consumer prices in the short term. Further hawkish comments, as well as the first interest-rate hike, from the US Federal Reserve have now led to expectations of seven rate hikes in 2022. Meanwhile, the conflict in Ukraine has left investors uncertain about the timeline of rate hikes in Europe, although the European Central Bank has not ruled out rate hikes in 2022.

Risk factors you should consider before investing:

a. The value of an investment and the income from them can fall as well as rise and is not guaranteed. An investor may get back less than they put in. Past Performance is not a guide to future performance.

b. Investing globally can bring additional returns and diversify risk. However, currency exchange rate fluctuations may have a positive or negative impact on the value of your investment.

c. Bonds are affected by changes in interest rates, inflation and any decline in creditworthiness of the bond issuer. The fund's portfolio may have significant exposure to bonds that typically have lower ratings. Bonds that produce a higher level of income usually also carry greater risk as such bond issuers may not be able to pay the bond income as promised or could fail to repay the capital amount used to purchase the bond. Where a bond market has a low number of buyers and/or a high number of sellers, it may be harder to sell particular bonds at an anticipated price and/or in a timely manner.

d. Contingent convertible bonds can automatically convert into shares or be written down if the financial strength of the issuer falls in a certain way. This may result in substantial or total losses of the bond value.

e. The Sub-fund can use derivatives in order to meet its investment objectives or to protect from price and currency movements. This may result in gains or losses that are greater than the original amount invested. The fund does not make extensive use of derivatives.

f. Emerging markets or less developed countries may face more political, economic or structural challenges than developed countries. This may mean your money is at greater risk. The Fund may also invest in Frontier Markets which involves similar risks, but to a greater extent since they tend to be even smaller, less developed, and less accessible than other Emerging Markets.

Cumulative and Annualised performance as at 31/03/2022

	3 Months %	1 Year %	3 Years (p.a.) %	5 Years (p.a.) %	Since Launch (p.a.) %
Standard Life Diversified Income Fund	-3.4	5.9	3.8	--	2.2

Discrete annual performance year to 31/03

	2022	2021	2020	2019	2018
Standard Life Diversified Income Fund	5.9	16.3	-9.3	--	--

Fund performance has been calculated net of Annual Management Charge.
Source: abrdn

Past performance is not a guide to future results. The value of investments, and the income from them, can go down as well as up and an investor may get back less than the amount invested. This investment may be affected by changes in currency exchange rates.

Performance

Infrastructure was the main contributor, while emerging market (EM) bonds, listed equity, private equity and absolute return detracted. Investment markets suffered a volatile quarter, initially due to concerns over inflation and the potential for interest rate rises and latterly over Russia's invasion of Ukraine.

Following a strong end to 2021, volatility returned to equity markets in the first quarter, with global equities delivering a negative return. Against this backdrop, our sustainable core equity allocation performed broadly in line with global equities. Our UK mid-cap satellite underperformed given the exposure to growth stocks. Our EuroStoxx 50 dividend futures strategy outperformed early on but ended the quarter broadly in line after falls in early March.

Property produced a flat performance over the quarter. Infrastructure delivered a positive return, with contributions coming from a number of different holdings. A number of renewable infrastructure companies announced strong fourth-quarter NAV returns continuing the trend witnessed in recent quarters. The renewable companies continue to raise additional capital and find attractive investment opportunities.

Returns from asset-backed securities (ABS) were slightly negative. Spreads across ABS experienced limited volatility in the first half of the quarter, resulting in relatively stable performance versus other areas of fixed income.

Our allocation to local-currency EM bonds produced a negative return over the quarter, driven by write-downs to the Russian and Ukrainian bonds held. At the start of the quarter, we had exposure to both Russian and Ukrainian bonds, with the investment case for both credits appealing. However, events in late 2021 and early 2022 led our EM debt team to re-evaluate the investment cases. Special opportunities produced a small positive performance over the quarter.

g. Investments in REITs and companies engaged in the business of real estate may be subject to increased liquidity risk and price volatility due to a variety of factors, including local, regional and national economic and political conditions, interest rates and tax considerations.

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