




Fixed Income Update

Prepared for the New Wave

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Lengte

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Although the shutdown of activities has made the recovery more sluggish than ever, both Central banks and governments are providing unprecedented support, as confirmed by Christine Lagarde during the ECB monetary policy meeting last week, while a vaccine could be approved in the coming months opening the door for higher inflation expectations and positive economic surprises. The recent stricter lockdown measures implemented in Western countries don't have a significant impact on our base case scenario of having a vaccine produced and distributed in H2 2021.

To navigate this “lower rate for longer” environment, our Fixed Income strategies follow a “Barbell strategy”, balancing a high conviction core allocation to selective corporate credit, European subordinated financial debt and sovereign bonds (non-core Europe & EM) while counterbalancing these exposures by higher level of cash & equivalents, long duration towards core sovereign yields and an active management of protections & cash.

Our views by region:



UNITED STATES



The Federal Reserve is expected to support the recovery and prevent any unwarranted tightening of financial condition. Having a slightly long bias in US duration positions help Fixed Income portfolios in case of risk-off environment, that could arise be it linked to the virus/vaccine, growth-related, tight elections even if democratic sweep seems largely priced in but both polls & bookmakers have been wrong and dispute over results remains a possibility.

EUROZONE





In the Euro Area, valuations induce a limited downside potential on rates which would require further rate cut which appear unlikely over the short-term. Lagarde dovish intervention last week has confirmed that the ECB should intervene in December, probably through PEPP extension and/or further TLTROs which should favor carry strategies and potential spread compression on non-core sovereign debt and corporate credit bonds.

G10 COUNTRIES



In G10 countries, Australia appears particularly attractive on the rates side. We could see more easing going forward even if the RBA cut rates and announced a \$A100 QE recently. Going forward, the fiscal policy should be more expansionist which would require the Reserve Bank of Australia to reinforce its non-conventional monetary policies to absorb the expected higher debt supply and to depreciate the currency.



EMERGING MARKETS



At this stage, we remain cautious on emerging markets given the decline in capital flows and a fall in exports. Nevertheless, from a macro perspective, our team is closely monitoring the situation as the weaker US Dollar could lead to a more positive context for EM. Even if the overall EMD asset class does not present a very attractive risk/return profile, some countries represent an opportunity to continue generating higher returns like China, as slow employment recovery and the importance of the services sector suggests that the PBoC should keep a dovish policy for some time. Valuation wise, Chinese 5-year spreads versus developed market are close to all-time high at roughly +3% (source: Bloomberg, index W2G1).

To understand our positioning by Fund:

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