MARKETING COMMUNICATION FOR PROFESSIONAL INVESTORS IN ITALY, FRANCE, AUSTRIA, GERMANY, SPAIN, PORTUGAL AND LUXEMBOURG.

FIXED INCOME OUTLOOK

Navigating the final stretch of 2024

OCTOBER 2024

The onset of a new rate-cutting cycle, coupled with divergent regional economic growth trends, presents a promising landscape for active bond managers. Yet inflationary and geopolitical risks lurk in the background. Against a macro environment with many moving parts, five fixed income managers from across Generali Investments explain their investment views for the last leg of 2024.

Markets are confident that central banks have acted swiftly enough to avert a recession, and the pricing of future aggressive rate cuts has pushed bond yields lower. The focus now shifts to how quickly economies will respond to monetary easing, and whether these cuts can sustain growth without reigniting inflationary pressures.

“We expect the global growth cycle to prove resilient, and the recent Chinese policy stimulus announcement further reduces the left tail risks”, say the Market & Macro Research Team at Generali Asset Management. “We see upside and downside medium-term risks for inflation, which has become harder to predict. Rates volatility should normalise further but may not return to the pre-Covid lows.”

Mauro Valle
Head of Fixed Income,
Generali Asset Management

SHORT TO MEDIUM-TERM EUROPEAN BONDS SHOULD SHINE

In the last quarter of the year, expectations are for stable, lower interest rates. However, the decline in yields is likely to be more pronounced for short and medium-term maturities, as this part of the curve will be supported by the expected cuts. In our view, an appropriate bond strategy should focus on maintaining an adequate duration exposure while positioning appropriately along the yield curve, as the curve may consolidate its positive slope in the coming months after a long period of inversion.

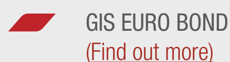
Investors should also bear in mind that in a clearly positive interest rate environment, the traditional negative correlation between equities and bonds - where equities fall and bonds rise - returns during periods of heightened volatility. Therefore, a long duration position provides a natural hedge for portfolios during risk-off periods in the market.

A similar strategy can be applied to portfolios invested in corporate bonds. Focusing on the right duration positioning can mitigate the negative effects of widening credit spreads, which tend to occur during periods of market risk aversion. For example, the market volatility in August led to a widening of spreads, but the impact of these wider spreads is likely to be mitigated by lower interest rates.

We are positive on investment grade corporate bonds. While credit spreads may be subject to volatility, particularly in investment grade, this segment remains attractive, especially as interest rate cuts are expected in the coming quarters. Given the compressed level of credit spreads, we prefer to work on the risk profile of credit portfolios by reducing beta, i.e. reducing riskier positions, rather than reducing credit exposure.

In terms of euro rates exposure, we favour a tactical approach to Bund exposure and short French OATs as the political scenario remains complex and fears about the ability to implement adequate fiscal policies are still present. We remain long Italian BTPs as we are confident of a favourable BTP/Bund spread. Our long positions in Spain, EU and Greece are confirmed. We remain long short to medium maturities, underweight the 15+ year segment of the yield curve and tactically long 10 year maturities. In short, we believe that a bond strategy with appropriate duration exposure and an overweight in the middle of the yield curve can deliver strong returns in the final months of 2024.

FUNDS IN FOCUS



GIS EURO BOND
(Find out more)

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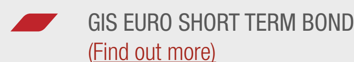

GIS EURO SHORT TERM BOND
(Find out more)

Mauro Ratto
Co-Founder & Co-Chief Investment Officer,
Plenisfer Investments

FLEXIBLE AND UNCONSTRAINED FOR THE LATE STAGE OF THE ECONOMIC CYCLE

Now is a particularly good time for an unconstrained approach to bonds, in my view, as flexibility to navigate shifting markets and capitalise on both interest rate cuts and credit opportunities will be key in the coming environment. We're entering the later stage of the economic cycle, where spreads tend to be tight, and an interest rate cut cycle is anticipated. In a complex, uncertain situation where it's not entirely clear if we are headed for a soft or hard landing economically, it will be crucial to be able to deconstruct performance into its key drivers, such as interest rate duration, credit exposure, and curve positioning.

When we look at the broader picture - especially the state of public finances globally - it's clear that sovereign balance sheets are not in great condition, which is unlikely to change anytime soon. In contrast, corporate balance sheets in the Western world remain strong, creating a unique scenario where corporate health is solid, but sovereign debt quality is lacking. This backdrop supports a multi-strategy approach, focusing on shorter spread duration and exposure to the most attractive parts of the yield curve, particularly the short and mid sections. While the yield curve steepening is still in its early stages, we expect it to strengthen as rate cuts progress, benefiting sectors like banking and finance.

We continue to prioritize quality over risk in our strategy, especially in uncertain times. Subordinated debt from quality issuers remains a focus because of the protection cash flows offer. Recent market volatility, triggered by economic data, underscores the need for caution. Even so, the US yield curve offers value, with real rates remaining positive. Although inflation is moving toward 2-2.5%, the short end still provides room for rate cuts, leaving scope for meaningful real returns.

We favour sectors that generate strong cash flows and have solid balance sheets, like energy, financials, and parts of telecommunications and utilities. Meanwhile, emerging markets - especially in local currency debt - offer compelling opportunities. Countries like India, Indonesia, Brazil, and Mexico have proactively managed inflation, providing attractive real rates despite some volatility.

Looking to the upcoming US election, we don't foresee the outcome significantly impacting monetary policy or foreign affairs. While the election might make headlines, it's unlikely to cause any substantial shifts in policy that would materially affect markets, with little effect on the Fed's trajectory or US exceptionalism in foreign policy, unlike the shock markets experienced in 2016, where there was a genuine surprise factor.

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PLENISFER INVESTMENTS DESTINATION DYNAMIC INCOME TOTAL RETURN (Find out more)

Simon Thorp
CIO of Corporate Credit,
Aperture Investors

HIGH DISPERSION PROVIDES A RICH SEAM OF LONG-SHORT CREDIT OPPORTUNITIES

Corporate credit markets have experienced strong total return performance over the past 12 months (15.2% in the US and 10.6% in Europe[1]) driven by the combination of better-than-expected growth and falling inflation. Investors have continued to allocate heavily to the asset class in anticipation of lower yields and tighter spreads.

Post these strong returns, we remain constructive on corporate credit but believe that some caution is warranted as the cycle extends and spreads reach levels that are tight by historic standards. This is reflected in the increased interest in hedged credit products.

Alongside our constructiveness is the observation of the high level of dispersion in credit markets – the best in over five years – which we believe provides a rich seam of opportunities for fundamental credit pickers, both long and short.

We have positioned our portfolios to be long duration to benefit from what we believe to be a continued gradual fall in rates and yields into 2025, with a preference for short duration US high yield BBs & Bs, some longer duration (8-10 year) undervalued high yield corporate bonds, as well as European bank AT1s.

In terms of sectors we like going forward, we continue to prefer European financials, energy, TMT, transport and media. We are cautious on US regional banks, certain segments of the retail sector and weaker credits with looming 2025 and 2026 maturities. We think that financial markets will continue to be buffeted by headwinds into 2025 but that the long/short investing environment in corporate credit will remain appealing for at least the medium-term.

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APERTURE INVESTORS SICAV CREDIT OPPORTUNITIES
(Find out more)

[1] Source: Aperture Investors. Represented by the HYG Index in the US and IHYG Index in Europe, as at 10 October 2024.

Witold Bahrke
Senior Macro & Allocation Strategist,
Global Evolution

EMERGING AND FRONTIER MARKET DEBT – ATTRACTIVE YIELDS AND AN OVERLOOKED REFLATION HEDGE

A number of key factors currently underpin a remarkably positive environment for emerging market debt (EMD) and frontier markets. First, we believe the economic cycle is bending, not breaking – while growth is cooling, we don't expect a recession in the next few quarters. The neutral rate, or the economy's interest rate pain threshold, has risen, and the US labour market remains resilient. Inflation has come off the boil, allowing central banks to begin loosening policies. Easing policies provide fertile ground for future EM bond returns, and they tend to outperform developed market (DM) high yield (HY) bonds in such a macro environment. EM hard currency (HC) bonds offer a yield-to-maturity (YTM) of 7.7%, providing a meaningful yield pick-up relative to DM HY bonds. Frontier markets offer even higher yields of 13.5% and significantly lower volatility than, say, DM HY.

Longer term, emerging markets have strengthened their macroeconomic foundations, with improved growth-inflation dynamics and declining external debt ratios. Outside China, leverage has only risen moderately. Policy discipline has improved, with central banks generally being ahead of the curve in fighting inflation. Post-pandemic, EM economies' fiscal balances deteriorated less than their DM peers, allowing EM inflation to return to pre-pandemic levels. The resulting improved growth-inflation trade-off and reduced macro-financial risks enhance the risk-reward profile of EM bonds.

We currently favor dollar-denominated EM bonds over local currency bonds. Markets may have priced in too many Fed cuts, and the upcoming US election adds upside risk to the US dollar. We hold a slightly below-average credit risk position but are looking for opportunities to shift into local currency bonds post-election: tactically, they tend to perform well when monetary conditions ease, while structurally, they are also well positioned to benefit from improving growth-inflation dynamics.

Countries such as Turkey, Ecuador, and Argentina stand out for their reform momentum. Turkey's recent economic policy changes and real rates support carry trade opportunities. Ecuador's new government and Argentina's potential macroeconomic turnaround also look promising. Finally, frontier markets are attractive due to their high yields, diversification merits, and low duration, offering an effective hedge against the risk of reflation and rising yields. From a risk-reward perspective, we believe this makes frontier markets an outstanding (and somewhat overlooked) investment choice.

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GLOBAL EVOLUTION FRONTIER MARKETS
(Find out more)

GLOBAL EVOLUTION EMERGING MARKETS HARD CURRENCY DEBT (Find out more)

Stanislas de Baillencourt
Head of Asset Allocation & Fixed Income,
Sycomore Asset Management

DYNAMIC PRIMARY MARKETS HOLD OPPORTUNITIES FOR RESPONSIBLE CREDIT

We believe the peak in inflation has passed, and we are now moving towards a lower inflationary environment, which is likely to result in a soft landing with subdued global growth. This shift has provided central banks with the opportunity to start adjusting their monetary policies, offering markets more visibility. However, we think market expectations may be somewhat optimistic for rate cuts, though the overall trend towards lower cash yields from both the ECB and the Federal Reserve is clear.

While we anticipate slower growth, especially in Europe and China, this scenario remains constructive for businesses and, by extension, for credit markets. The expected reduction in interest rates has already impacted all points across the yield curve. Although yields have decreased significantly over the past three months – perhaps too sharply – we believe the longer-term outlook is supportive. In the short term, we may see some minor corrections, but overall, the environment remains attractive.

Our responsible credit strategies have benefited from these conditions over the past two years, and we are confident that the months ahead will continue to provide favourable opportunities. As a responsible investment firm, we are committed to adding value in the current market environment. We are seeing highly dynamic primary markets, with many companies refinancing their bonds. Our thorough analysis includes a strong focus on Socially Responsible Investing (SRI), ensuring alignment between companies and our strategies, particularly in the area of governance – which is key to maintaining strong credit quality and mitigating the risk of credit events.

We see responsible investment grade as a particularly rich source of opportunities, particularly those transitioning to more sustainable practices, with a focus on positive environmental impact. We continue to view crossover credit as attractive, particularly within the double-B and triple-B segments, which have been the core focus of our responsible credit strategy for over a decade.

In short, despite the prospect of slower growth, companies are performing well, and while default rates are likely to rise from their current all-time lows, we believe they will remain low for an extended period. This, combined with rigorous SRI analysis that further enhances risk-reward, offers a constructive environment for credit investment.

FUND IN FOCUS

SYCOMORE SÉLECTION CRÉDIT
(Find out more)

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GIS EURO AGGREGATE BOND - Credit Risk, Derivatives Risk and Sustainable Finance Risk
GIS EURO SHORT TERM BOND - Credit Risk, Derivatives Risk and Sustainable Finance Risk
PLENISFER INVESTMENTS DESTINATION DYNAMIC INCOME TOTAL RETURN - Interest Rate Risk, Credit Risk and Emerging Markets Risk
APERTURE INVESTORS SICAV CREDIT OPPORTUNITIES - Interest Rate Risk, Credit Risk and Emerging Markets Risk
GLOBAL EVOLUTION FRONTIER MARKETS - Market Developments Risk, Country Crisis Risk, Global Financial Crisis Risk and Liquidity Risk
GLOBAL EVOLUTION EMERGING MARKETS HARD CURRENCY DEBT - Changes in Legislation Risk, Counterparty Risk, Credit and Market Risk
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* There is no guarantee that an investment objective will be achieved or that a return on capital will be obtained. The product does not benefit from any guarantee to protect the capital.

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